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The Origins of the Federal Reserve **Murray N. Rothbard**

Credit Creation or Financial Intermediation?: Fractional-Reserve Banking in a Growing Economy
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The Noblest Triumph: Property and Prosperity Through the Ages **Tom Bethell**
Reviewed by Walter Block

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THE ORIGINS OF THE FEDERAL RESERVE

MURRAY N. ROTHBARD

THE PROGRESSIVE MOVEMENT

The Federal Reserve Act of December 23, 1913 was part and parcel of the wave of Progressive legislation, on local, state, and federal levels of government, that began about 1900. Progressivism was a bipartisan movement which, in the course of the first two decades of the twentieth century, transformed the American economy and society from one of roughly laissez-faire to one of centralized statism.

Until the 1960s, historians had established the myth that Progressivism was a virtual uprising of workers and farmers who, guided by a new generation of altruistic experts and intellectuals, surmounted fierce big business opposition in order to curb, regulate, and control what had been a system of accelerating monopoly in the late nineteenth century. A generation of research and scholarship, however, has now exploded that myth for all parts of the American polity, and it has become all too clear that the truth is the reverse of this well-worn fable. In contrast, what actually happened was that business became increasingly competitive during the late nineteenth century, and that various big-business interests, led by the powerful financial house of J.P. Morgan and Company, tried desperately to establish successful cartels on the free market. The first wave of such cartels was in the first large-scale business—railroads. In every case, the attempt to increase profits, by cutting sales with a quota system and thereby to raise prices or rates, collapsed quickly from internal competition within the cartel and from external competition by new competitors eager to undercut the cartel. During the 1890s, in the new field of large-scale industrial corporations, big-business interests tried to establish high prices and reduced production via mergers, and again, in every case, the merger collapsed from the winds of new competition. In both sets of cartel attempts, J.P. Morgan and Company had taken the lead, and in both sets of cases,

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EDITORS' NOTE: Murray N. Rothbard (1926–1995) was the S.J. Hall distinguished professor of economics at the University of Nevada, Las Vegas. This is an unpublished manuscript from the Rothbard papers, written in 1984, and will appear as a chapter in a forthcoming book to be published by the Ludwig von Mises Institute entitled *A History of Money in the United States: The Colonial Era to World War II.*

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the market, hampered though it was by high protective tariff walls, managed to nullify these attempts at voluntary cartelization.

It then became clear to these big-business interests that the only way to establish a cartelized economy, an economy that would insure their continued economic dominance and high profits, would be to use the powers of government to establish and maintain cartels by coercion, in other words, to transform the economy from roughly laissez-faire to centralized and coordinated statism. But how could the American people, steeped in a long tradition of fierce opposition to government-imposed monopoly, go along with this program? How could the public's consent to the New Order be engineered?

Fortunately for the cartelists, a solution to this vexing problem lay at hand. Monopoly could be put over *in the name of* opposition to monopoly! In that way, using the rhetoric beloved by Americans, the *form* of the political economy could be maintained, while the *content* could be totally reversed. Monopoly had always been defined, in the popular parlance and among economists, as "grants of exclusive privilege" by the government. It was now simply redefined as "big business" or business competitive practices, such as price-cutting, so that regulatory commissions, from the Interstate Commerce Commission (ICC) to the Federal Trade Commission (FTC) to state insurance commissions were lobbied for and staffed with big-business men from the regulated industry, all done in the name of curbing "big-business monopoly" on the free market. In that way, the regulatory commissions could subsidize, restrict, and cartelize in the name of "opposing monopoly," as well as promoting the general welfare and national security. Once again, it was railroad monopoly that paved the way.

For this intellectual shell game, the cartelists needed the support of the nation's intellectuals, the class of professional opinion-molders in society. The Morgans needed a smokescreen of ideology, setting forth the rationale and the apologetics for the New Order. Again, fortunately for them, the intellectuals were ready and eager for the new alliance. The enormous growth of intellectuals, academics, social scientists, technocrats, engineers, social workers, physicians, and occupational "guilds" of all types in the late nineteenth century led most of these groups to organize for a far greater share of the pie than they could possibly achieve on the free market. These intellectuals needed the State to license, restrict, and cartelize their occupations, so as to raise the incomes for the fortunate people already in these fields. In return for their serving as apologists for the new statism, the State was prepared to offer not only cartelized occupations, but also ever-increasing and cushier jobs in the bureaucracy to plan and propagandize for the newly statized society. And the intellectuals were ready for it, having learned in graduate schools in Germany the glories of statism and organicist socialism, of a harmonious "middle way" between dog-eat-dog laissez-faire on the one hand and proletarian Marxism on the other. Instead, big government, staffed by intellectuals and technocrats, steered by big business and aided by unions organizing a subservient labor force, would impose a cooperative commonwealth for the alleged benefit of all.

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UNHAPPINESS WITH THE NATIONAL BANKING SYSTEM

The previous big push for statism in America had occurred during the Civil War, when the virtual one-party Congress after secession of the South emboldened the Republicans to enact their cherished statist program under cover of the war. The alliance of big business and big government with the Republican party drove through an income tax, heavy excise taxes on such sinful products as tobacco and alcohol, high protective tariffs and huge land grants and other subsidies to trans-continental railroads. The overbuilding of railroads led directly to Morgan's failed attempts at railroad pools, and finally to the creation, promoted by Morgan and Morgan-controlled railroads, of the Interstate Commerce Commission in 1887. The result of that was the long secular decline of the railroads beginning before 1900. The income tax was annulled by Supreme Court action, but was reinstated during the Progressive period.

The most interventionary of the Civil War actions was in the vital field of money and banking. The approach toward hard-money and free banking that had been achieved during the 1840s and 1850s was swept away by two pernicious inflationist measures of the wartime Republican administration. One was fiat money greenbacks, which depreciated by half by the middle of the Civil War. These were finally replaced by the gold standard after urgent pressure by hard-money Democrats, but not until 1879, fourteen full years after the end of the war. A second, and more lasting, intervention was the National Banking Acts of 1863, 1864, and 1865, which destroyed the issue of bank notes by state-chartered (or "state") banks by a prohibitory tax, and then monopolized the issue of bank notes in the hands of a few large federally chartered "national banks," mainly centered on Wall Street. In a typical cartelization, national banks were compelled by law to accept each other's notes and demand deposits at par, negating the process by which the free market had previously been discounting the notes and deposits of shaky and inflationary banks.

In this way, the Wall Street-federal government establishment was able to control the banking system, and inflate the supply of notes and deposits in a coordinated manner.

But there were still problems. The national banking system provided only a halfway house between free banking and government central banking, and by the end of the nineteenth century, the Wall Street banks were becoming increasingly unhappy with the status quo. The centralization was only limited, and, above all, there was no governmental central bank to coordinate inflation, and to act as a lender of last resort, bailing out banks in trouble. As soon as bank credit generated booms, then they got into trouble; bank-created booms turned into recessions, with banks forced to contract their loans and assets and to deflate in order to save themselves. Not only that, but after the initial shock of the National Banking Acts, state banks had grown rapidly by pyramiding their loans and demand deposits on top of national bank notes. These state banks, free of the high legal capital requirements that kept

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entry restricted in national banking, flourished during the 1880s and 1890s and provided stiff competition for the national banks themselves. Furthermore, St. Louis and Chicago, after the 1880s, provided increasingly severe competition to Wall Street. Thus, St. Louis and Chicago bank deposits, which had been only 16 percent of the St. Louis, Chicago, and New York City total in 1880, rose to 33 percent of that total by 1912. All in all, bank clearings outside of New York City, which were 24 percent of the national total in 1882, had risen to 43 percent by 1913.

The complaints of the big banks were summed up in one word: "inelasticity." The national banking system, they charged, did not provide for the proper "elasticity" of the money supply; that is, the banks were not able to expand money and credit as much as they wished, particularly in times of recession. In short, the national banking system did not provide sufficient room for inflationary expansions of credit by the nation's banks.[1]

By the turn of the century the political economy of the United States was dominated by two generally clashing financial aggregations: the previously dominant Morgan group, which began in investment banking and then expanded into commercial banking, railroads, and mergers of manufacturing firms; and the Rockefeller forces, which began in oil refining and then moved into commercial banking, finally forming an alliance with the Kuhn, Loeb Company in investment banking and the Harriman interests in railroads.[2]

Although these two financial blocs usually clashed with each other, they were as one on the need for a central bank. Even though the eventual major role in forming and dominating the Federal Reserve System was taken by the Morgans, the Rockefeller and Kuhn, Loeb forces were equally enthusiastic in pushing, and collaborating on, what they all considered to be an essential monetary reform.

THE BEGINNINGS OF THE "REFORM" MOVEMENT: THE INDIANAPOLIS MONETARY CONVENTION

The presidential election of 1896 was a great national referendum on the gold standard. The Democratic party had been captured, at its 1896 convention, by the populist, ultra-inflationist anti-gold forces, headed by William Jennings Bryan. The older Democrats, who had been fiercely devoted to hard-money and the gold standard, either stayed home on election day or voted, for the first time in their lives, for the hated Republicans. The Republicans had long been the party of

[1]On the National Banking System background and on the increasing unhappiness of the big banks, see Murray N. Rothbard (1984, pp. 89–94), Ron Paul and Lewis Lehrman (1982), and Gabriel Kolko (1983, pp. 139–46).

[2]Indeed, much of the political history of the United States from the late nineteenth century until World War II may be interpreted by the closeness of each administration to one of these sometimes cooperating, more often conflicting, financial groupings: Cleveland (Morgan), McKinley (Rockefeller), Theodore Roosevelt (Morgan), Taft (Rockefeller), Wilson (Morgan), Harding (Rockefeller), Coolidge (Morgan), Hoover (Morgan), or Franklin Roosevelt (Harriman–Kuhn–Loeb–Rockefeller).

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prohibition and of greenback inflation and opposition to gold. But since the early 1890s, the Rockefeller forces, dominant in their home state of Ohio and nationally in the Republican party, had decided to quietly ditch prohibition as a political embarrassment and as a grave deterrent to obtaining votes from the increasingly powerful bloc of German-American voters. In the summer of 1896, anticipating the defeat of the gold forces at the Democratic convention, the Morgans, previously dominant in the Democratic party, approached the McKinley-Mark Hanna-Rockefeller forces through their rising young satrap, Congressman Henry Cabot Lodge of Massachusetts. Lodge offered the Rockefeller forces a deal: the Morgans would support McKinley for president, and neither sit home nor back a third, Gold Democrat party, provided that McKinley pledged himself to a gold standard. The deal was struck, and many previously hard-money Democrats shifted to the Republicans. The nature of the American political party system was now drastically changed: what was previously a tightly-fought struggle between hard-money, free-trade, laissez-faire Democrats on the one hand, and protectionist, inflationist and statist Republicans on the other, with the Democrats slowly but surely gaining ascendancy by the early 1890s was now a party system dominated by the Republicans until the depression election of 1932.

The Morgans were strongly opposed to Bryanism, which was not only populist and inflationist, but also anti-Wall Street bank; the Bryanites, much like populists of the present-day, preferred Congressional, greenback inflationism to the more subtle, and more privileged, big-bank-controlled variety. The Morgans, in contrast, favored a gold standard. But, once gold was secured by the McKinley victory of 1896, they wanted to press on to use the gold standard as a hard-money camouflage behind which they could change the system into one less nakedly inflationist than populism but far more effectively controlled by the big-banker elites. In the long run a controlled Morgan-Rockefeller gold standard was far more pernicious to the cause of genuine hard-money than a candid free-silver or greenback Bryanism.

As soon as McKinley was safely elected, the Morgan-Rockefeller forces began to organize a "reform" movement to cure the "inelasticity" of money in the existing gold standard and to move slowly toward the establishment of a central bank. To do so, they decided to use the techniques they had successfully employed in establishing a pro-gold standard movement during 1895 and 1896. The crucial point was to avoid the public suspicion of Wall Street and banker control by acquiring the patina of a broad-based grassroots movement. The movement, therefore, was deliberately focused in the Middle West, the heartland of America, and organizations developed that included not only bankers, but also businessmen, economists and other academics, who supplied respectability, persuasiveness, and technical expertise to the reform cause.

Accordingly, the reform drive began just after the 1896 elections in authentic Midwest country. Hugh Henry Hanna, president of the Atlas Engine Works of Indianapolis, who had learned organizing tactics during the year with the pro-gold

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standard Union for Sound Money, sent a memorandum, in November, to the Indianapolis Board of Trade, urging a grassroots, midwestern state like Indiana to take the lead in currency reform.[3]

In response, the reformers moved fast. Answering the call of the Indianapolis Board of Trade, delegates from boards of trade from twelve midwestern cities met in Indianapolis on December 1, 1896. The conference called for a large monetary convention of businessmen, which accordingly met in Indianapolis on January 12, 1897. Representatives from twenty-six states and the District of Columbia were present. The monetary reform movement was now officially underway. The influential *Yale Review* commended the convention for averting the danger of arousing popular hostility to bankers. It reported that "the conference was a gathering of businessmen in general rather than bankers in particular" (quoted in Livingston 1986, p. 105).

The conventioneers may have been businessmen, but they were certainly not very grass-rootsy. Presiding at the Indianapolis Monetary Convention of 1897 was C. Stuart Patterson, dean of the University of Pennsylvania Law School and a member of the finance committee of the powerful, Morgan-oriented Pennsylvania Railroad. The day after the convention opened, Hugh Hanna was named chairman of an executive committee which he would appoint. The committee was empowered to act for the convention after it adjourned. The executive committee consisted of the following influential corporate and financial leaders:

John J. Mitchell of Chicago, president of the Illinois Trust and Savings Bank, and a director of the Chicago and Alton Railroad, the Pittsburgh, Fort Wayne and Chicago Railroad, and the Pullman Company, was named treasurer of the executive committee.

H.H. Kohlsaat, editor and publisher of the Chicago *Times Herald*, the Chicago *Ocean Herald*, trustee of the Chicago Art Institute, and a friend and advisor of Rockefeller's main man in politics, President William McKinley.

Charles Custis Harrison, provost of the University of Pennsylvania, who had made a fortune as a sugar refiner in partnership with the powerful Havemeyer ("Sugar Trust") interests.

Alexander E. Orr, New York City banker in the Morgan ambit, who was a director of the Morgan-run Erie and Chicago, Rock Island and Pacific railroads, the National Bank of Commerce, and the influential publishing house of Harper Brothers. Orr was also a partner in the country's largest grain merchandising firm and a director of several life insurance companies.

Edwin O. Stanard, St. Louis grain merchant, former governor of Missouri, and former vice president of the National Board of Trade and Transportation.

E.B. Stahlman, owner of the Nashville Banner, commissioner of the cartelist Southern Railway and Steamship Association and former vice president of the Louisville, New Albany, and Chicago Railroad.

[3]For the memorandum, see James Livingston (1986, pp. 104–05).

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A.E. Willson, influential attorney from Louisville and a future governor of Kentucky.

But the two most interesting and powerful executive committee members of the Monetary Convention were Henry C. Payne and George Foster Peabody. Henry Payne was a Republican party leader from Milwaukee, and president of the Morgan-dominated Wisconsin Telephone Company, long associated with the railroad-oriented Spooner-Sawyer Republican machine in Wisconsin politics. Payne was also heavily involved in Milwaukee utility and banking interests, in particular as a long-time director of the North American Company, a large public utility holding company headed by New York City financier Charles W. Wetmore. So close was North American to the Morgan interests that its board included two top Morgan financiers. One was Edmund C. Converse, president of Morgan-run Liberty National Bank of New York City, and soon to be founding president of Morgan's Bankers Trust Company. The other was Robert Bacon, a partner in J.P. Morgan and Company, and one of Theodore Roosevelt's closest friends, whom Roosevelt would make assistant secretary of state. Furthermore, when Theodore Roosevelt became president as the result of the assassination of William McKinley, he replaced Rockefeller's top political operative, Mark Hanna of Ohio, with Henry C. Payne as Postmaster General of the United States. Payne, a leading Morgan lieutenant, was reportedly appointed to what was then the major political post in the Cabinet, specifically to break Hanna's hold over the national Republican party. It seems clear that replacing Hanna with Payne was part of the savage assault that Theodore Roosevelt would soon launch against Standard Oil as part of the open warfare about to break out between the Rockefeller-Harriman-Kuhn, Loeb, and the Morgan camps (Burch 1981, p. 189, n. 55).

Even more powerful in the Morgan ambit was the secretary of the Indianapolis Monetary Convention's executive committee, George Foster Peabody. The entire Peabody family of Boston Brahmins had long been personally and financially closely associated with the Morgans. A member of the Peabody clan had even served as best man at J.P. Morgan's wedding in 1865. George Peabody had long ago established an international banking firm of which J.P. Morgan's father, Junius, had been one of the senior partners. George Foster Peabody was an eminent New York investment banker with extensive holdings in Mexico. He helped reorganize General Electric for the Morgans, and was later offered the job of secretary of the treasury during the Wilson administration. He would function throughout that administration as a "statesman without portfolio" (ibid., pp. 231, 233; Ware 1951, pp. 161-67).

Let the masses be hoodwinked into regarding the Indianapolis Monetary Convention as a spontaneous grassroots outpouring of small midwestern businessmen. To the *cognoscenti*, any organization featuring Henry Payne, Alexander Orr, and especially George Foster Peabody meant but one thing: J.P. Morgan.

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The Indianapolis Monetary Convention quickly resolved to urge President McKinley to (1) continue the gold standard and (2) create a new system of "elastic" bank credit. To that end, the convention urged the president to appoint a new Monetary Commission to prepare legislation for a new revised monetary system. McKinley was very much in favor of the proposal, signalling Rockefeller agreement, and on July 24 he sent a message to Congress urging the creation of a special monetary commission. The bill for a national monetary commission passed the House of Representatives but died in the Senate (Kolko 1983, pp. 147–48).

Disappointed but intrepid, the executive committee, failing a presidentially appointed commission, decided in August 1897 to go ahead and select its own. The leading role in appointing this commission was played by George Foster Peabody, who served as liaison between the Indianapolis members and the New York financial community. To select the commission members, Peabody arranged for the executive committee to meet in the Saratoga Springs summer home of his investment banking partner, Spencer Trask. By September, the executive committee had selected the members of the Indianapolis Monetary Commission.

The members of the new Indianapolis Monetary Commission were as follows (Livingston 1986, pp. 106–07):

Chairman was former Senator George F. Edmunds, Republican of Vermont, attorney, and former director of several railroads.

C. Stuart Patterson was dean of University of Pennsylvania Law School, and a top official of the Morgan-controlled Pennsylvania Railroad.

Charles S. Fairchild, a leading New York banker, president of the New York Security and Trust Company, was a former partner in the Boston Brahmin investment banking firm of Lee, Higginson and Company, and executive and director of two major railroads. Fairchild, a leader in New York state politics, had been secretary of the treasury in the first Cleveland Administration. In addition, Fairchild's father, Sidney T. Fairchild, had been a leading attorney for the Morgan-controlled New York Central Railroad.

Stuyvesant Fish, scion of two long-time aristocratic New York families, was a partner of the Morgan-dominated New York investment bank of Morton, Bliss and Company, and then president of Illinois Central Railroad and a trustee of Mutual Life. Fish's father had been a senator, governor, and secretary of state.

Louis A. Garnett was a leading San Francisco businessman.

Thomas G. Bush of Alabama was a director of the Mobile and Birmingham Railroad.

J.W. Fries was a leading cotton manufacturer of North Carolina.

William B. Dean, merchant from St. Paul, Minnesota, and a director of the St. Paul-based transcontinental Great Northern Railroad, owned by James J. Hill, ally with Morgan in the titanic struggle over the Northern Pacific Railroad with Harriman, Rockefeller, and Kuhn, Loeb.

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George Leighton of St. Louiswas an attorney for the Missouri Pacific Railroad.

Robert S. Taylor was an Indiana patent attorney for the Morgan-controlled General Electric Company.

The single most important working member of the commission was James Laurence Laughlin, head professor of political economy at the new Rockefeller-founded University of Chicago and editor of its prestigious *Journal of Political Economy*. It was Laughlin who supervised the operations of the Commission's staff and the writing of the reports. Indeed, the two staff assistants to the Commission who wrote reports were both students of Laughlin at Chicago: former student L. Carroll Root, and his then current graduate student Henry Parker Willis.

The impressive sum of fifty thousand dollars was raised throughout the nation's banking and corporate community to finance the work of the Indianapolis Monetary Commission. New York City's large quota was raised by Morgan bankers Peabody and Orr, and heavy contributions to fill the quota came promptly from mining magnate William E. Dodge, cotton and coffee trader Henry Hentz, a director of the Mechanics National Bank, and J.P. Morgan himself.

With the money in hand, the executive committee rented office space in Washington, D.C. in mid-September and set the staff to sending out and collating the replies to a detailed monetary questionnaire, sent to several hundred selected experts. The Monetary Commission sat from late September into December 1897, sifting through the replies to the questionnaire collated by Root and Willis. The purpose of the questionnaire was to mobilize a broad base of support for the Commission's recommendations, which they could claim represented hundreds of expert views. Second, the questionnaire served as an important public relations device, making the Commission and its work highly visible to the public, to the business community throughout the country, and to members of Congress. Furthermore, through this device, the Commission could be seen as speaking for the business community throughout the country.

To this end, the original idea was to publish the Monetary Commission's preliminary report, adopted in mid-December, as well as the questionnaire replies in a companion volume. Plans for the questionnaire volume fell through, although it was later published as part of a series of publications on political economy and public law by the University of Pennsylvania (Livingston 1986, pp. 107–08).

Undaunted by the slight setback, the executive committee developed new methods of molding public opinion using the questionnaire replies as an organizing tool. In November, Hugh Hanna hired as his Washington assistant financial journalist Charles A. Conant, whose task was to propagandize and organize public opinion for the recommendations of the Commission. The campaign to beat the drums for the forthcoming Commission report was launched when Conant published an article in the December first issue of *Sound Currency* magazine, taking an advanced line on the Commission report, and bolstering the conclusions not only

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with his own knowledge of monetary and banking history, but also with frequent statements from the as yet unpublished replies to the staff questionnaire.

Over the next several months, Conant worked closely with Jules Guthridge, the general secretary of the Commission; they first induced newspapers throughout the country to print abstracts of the questionnaire replies. As Guthridge wrote some Commission members, he thereby stimulated "public curiosity" about the forthcoming report, and he boasted that by "careful manipulation" he was able to get the preliminary report "printed in whole or in part—principally in part—in nearly seventy-five-hundred newspapers, large and small." In the meantime, Guthridge and Conant orchestrated letters of support from prominent men across the country, when the preliminary report was published on January 3, 1898. As soon as the report was published, Guthridge and Conant made these letters available to the daily newspapers. Quickly, the two built up a distribution system to spread the gospel of the report, organizing nearly one-hundred-thousand correspondents "dedicated to the enactment of the commission's plan for banking and currency reform" (Livingston 1986, pp. 109–10).

The prime and immediate emphasis of the preliminary report of the Monetary Commission was to complete the promise of the McKinley victory by codifying and enacting what was already in place *de facto*: a single gold standard, with silver reduced to the status of subsidiary token currency. Completing the victory over Bryanism and free silver, however, was just a mopping-up operation; more important in the long run was the call raised by the report for banking reform to allow greater elasticity. Bank credit could then be increased in recessions and whenever seasonal pressure for redemption by agricultural country banks forced the large central reserve banks to contract their loans. The actual measures called for by the Commission were of marginal importance (more important was that the question of banking reform had been raised at all).

Since the public had been aroused by the preliminary report, the executive committee decided to organize the second and final meeting of the Indianapolis Monetary Convention, which duly met at Indianapolis on January 25, 1898. The second convention was a far grander affair than the first, bringing together four-hundred-and-ninety-six delegates from thirty-one states. Furthermore, the gathering was a cross-section of America's top corporate leaders. While the state of Indiana naturally had the largest delegation, of eighty-five representatives of boards of trade and chambers of commerce, New York sent seventy-four delegates, including many from the Board of Trade and Transportation, the Merchant's Association, and the Chamber of Commerce in New York City.

Such corporate leaders attended as Cleveland iron manufacturer Alfred A. Pope, president of the National Malleable Castings Company; Virgil P. Cline, legal counsel to Rockefeller's Standard Oil Company of Ohio; and C.A. Pillsbury, of Minneapolis–St. Paul, organizer of the world's largest flour mills. From Chicago came such business notables as Marshall Field and Albert A. Sprague, a director of the Chicago Telephone Company, subsidiary of the Morgan-controlled telephone

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monopoly, American Telephone and Telegraph Company. Not to be overlooked is delegate Franklin MacVeagh, a wholesale grocer from Chicago, an uncle of a senior partner in the Wall Street law firm of Bangs, Stetson, Tracy and MacVeagh, counsel to J.P. Morgan and Company. MacVeagh, who was later to become secretary of the treasury in the Taft administration, was wholly in the Morgan ambit. His father-in-law, Henry F. Eames, was the founder of the Commercial National Bank of Chicago, and his brother Wayne was soon to become a trustee of the Morgan-dominated Mutual Life Insurance Company.

The purpose of the second convention, as former Secretary of the Treasury Charles S. Fairchild candidly explained in his address to the gathering, was to mobilize the nation's leading businessmen into a mighty and influential reform movement. As he put it, "if men of business give serious attention and study to these subjects, they will substantially agree upon legislation, and thus agreeing, their influence will be prevailing." He concluded that "My word to you is, pull all together." Presiding officer of the convention, Iowa's Governor Leslie M. Shaw, was however, a bit disingenuous when he told the gathering, "You represent today not the banks, for there are few bankers on this floor. You represent the business industries and the financial interests of the country." There were plenty of bankers there, too (Livingston 1986, pp. 113–15). Shaw himself, later to be secretary of the treasury under Theodore Roosevelt, was a small-town banker in Iowa, and president of the Bank of Denison throughout his term as governor. More important in Shaw's outlook and career was the fact that he was a long-time close friend and loyal supporter of the Des Moines Regency, the Iowa Republican machine headed by the powerful Senator William Boyd Allison. Allison, who was to obtain the Treasury post for his friend, was in turn tied closely to Charles E. Perkins, a close Morgan ally, president of the Chicago, Burlington and Quincy Railroad, and kinsman of the powerful Forbes financial group of Boston, long tied in with the Morgan interests (Rothbard 1984, pp. 95–96).

Also serving as delegates to the second convention were several eminent economists, each of whom, however, came not as academic observers but as representatives of elements of the business community. Professor Jeremiah W. Jenks of Cornell, a proponent of trust cartelization by government and soon to become a friend and advisor of Theodore Roosevelt as governor, came as delegate from the Ithaca Business Men's Association. Frank W. Taussig of Harvard University represented the Cambridge Merchants' Association. Yale's Arthur Twining Hadley, soon to be the president of Yale, represented the New Haven Chamber of Commerce, and Frank M. Taylor of the University of Michigan came as representative of the Ann Arbor Business Men's Association. Each of these men held powerful posts in the organized economics profession, Jenks, Taussig, and Taylor serving on the currency committee of the American Economic Association. Hadley, a leading railroad economist, also served on the board of directors of Morgan's New York, New Haven, and Hartford and Atchison, Topeka, and Santa Fe Railroads.[4]

[4]On Hadley, Jenks, and especially Conant, see Carl P. Parrini and Martin J. Sklar (1983,

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Both Taussig and Taylor were monetary theorists who, while committed to a gold standard, urged reform that would make the money supply more elastic. Taussig called for an expansion of national bank notes, which would inflate in response to the "needs of business." As Taussig (quoted in Dorfman 1949, p. xxxvii; Parrini and Sklar 1983, p. 269) put it, the currency would then "grow without trammels as the needs of the community spontaneously call for increase." Taylor, too, as one historian puts it, wanted the gold standard to be modified by "a conscious control of the movement of money" by government "in order to maintain the stability of the credit system." Taylor justified governmental suspensions of specie payment to "protect the gold reserve" (Dorfman 1949, pp. 392–93).

On January 26, the convention delegates duly endorsed the preliminary report with virtual unanimity, after which Professor J. Laurence Laughlin was assigned the task of drawing up a more elaborate final report, which was published and distributed a few months later. Laughlin's—and the convention's—final report not only came out in favor of a broadened asset base for a greatly increased amount of national bank notes, but also called explicitly for a central bank that would enjoy a monopoly of the issue of bank notes.[5]

Meanwhile, the convention delegates took the gospel of banking reform to the length and breadth of the corporate and financial communities. In April 1898, for example, A. Barton Hepburn, president of the Chase National Bank of New York (at that time a flagship commercial bank for the Morgan interests), and a man who would play a large role in the drive to establish a central bank, invited Monetary Commissioner Robert S. Taylor to address the New York State Bankers' Association on the currency question, since "bankers, like other people, need instruction upon this subject." All the monetary commissioners, especially Taylor, were active during the first half of 1898 in exhorting groups of businessmen throughout the nation for monetary reform.

Meanwhile, in Washington, the lobbying team of Hanna and Conant were extremely active. A bill embodying the suggestions of the Monetary Commission was introduced by Indiana Congressman Jesse Overstreet in January, and was reported out by the House Banking and Currency Committee in May. In the meantime, Conant met almost continuously with the banking committee members. At each stage of the legislative process, Hanna sent circular letters to the convention delegates and to the public, urging a letter-writing campaign in support of the bill.

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pp. 559–78). The authors point out that Conant's and Hadley's major works of 1896 were both published by G.P. Putnam's Sons of New York. President of Putnam's was George Haven Putnam, a leader in the new banking reform movement. Ibid, p. 561 n 2.

[5]The final report, including its recommendations for a central bank, was hailed by F.M. Taylor, in his "The Final Report of the Indianapolis Monetary Commission," *Journal of Political Economy* 6 (June 1898): 293–322. Taylor also exulted that the convention had been "one of the most notable movements of our time—the first thoroughly organized movement of the business classes in the whole country directed to the bringing about of a radical change in national legislation" (ibid., p. 322).

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In this agitation, McKinley's Secretary of the Treasury Lyman J. Gage worked closely with Hanna and his staff. Gage sponsored similar bills, and several bills along the same lines were introduced in the House in 1898 and 1899. Gage, a friend of several of the monetary commissioners, was one of the top leaders of the Rockefeller interests in the banking field. His appointment as secretary of the treasury had been gained for him by Ohio's Mark Hanna, political mastermind and financial backer of President McKinley, and old friend, high-school classmate, and business associate of John D. Rockefeller, Sr. Before his appointment to the Cabinet, Gage was president of the powerful First National Bank of Chicago, one of the major commercial banks in the Rockefeller ambit. During his term in office, Gage tried to operate the Treasury as a central bank, pumping in money during recessions by purchasing government bonds on the open market, and depositing large funds with pet commercial banks. In 1900, Gage called vainly for the establishment of regional central banks.

Finally, in his last annual report as secretary of the treasury in 1901, Lyman Gage let the cat completely out of the bag, calling outright for a government central bank. Without such a central bank, he declared in alarm, "individual banks stand isolated and apart, separated units, with no tie of mutuality between them." Unless a central bank establishes such ties, Gage warned, the Panic of 1893 would be repeated (Livingston 1986, p. 153). When he left office early the next year, Lyman Gage took up his post as president of the Rockefeller-controlled U.S. Trust Company in New York City (Rothbard 1984, pp. 94–95).

THE GOLD STANDARD ACT OF 1900 AND AFTER

Any reform legislation had to wait until after the elections of 1898, for the gold forces were not yet in control of Congress. In the autumn, the executive committee of the Indianapolis Monetary Convention mobilized its forces, calling on no less than ninety-seven-thousand correspondents throughout the country through whom it had distributed the preliminary report. The executive committee urged its constituency to elect a gold standard Congress; when the gold forces routed the silverites in November, the results of the election were hailed by Hanna as eminently satisfactory.

The decks were now cleared for the McKinley administration to submit its bill, and the Congress that met in December 1899 quickly passed the measure; Congress then passed the conference report of the Gold Standard Act in March 1900.

The currency reformers had gotten their way. It is well known that the Gold Standard Act provided for a single gold standard, with no retention of silver money except as tokens. Less well-known are the clauses that began the march toward a more "elastic" currency. As Lyman Gage had suggested in 1897, national banks, previously confined to large cities, were now made possible with a small amount of capital in small towns and rural areas. And it was made far easier for national banks to issue notes. The object of these clauses, as one historian put it, was to satisfy an "increased demand for money at crop-moving time, and to meet popular cries for

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'more money' by encouraging the organization of national banks in comparatively undeveloped regions" (Livingston 1986, p. 123).

The reformers exulted over the passage of the Gold Standard Act, but took the line that this was only the first step on the much needed path to fundamental banking reform. Thus, Professor Frank W. Taussig of Harvard praised the act, and greeted the emergence of a new social and ideological alignment, caused by "strong pressure from the business community" through the Indianapolis Monetary Convention. He particularly welcomed the fact that the Gold Standard Act "treats the national banks not as grasping and dangerous corporations but as useful institutions deserving the fostering care of the legislature." But such tender legislative care was not enough; fundamental banking reform was needed. For, Taussig declared, "the changes in banking legislation are not such as to make possible any considerable expansion of the national system or to enable it to render the community the full service of which it is capable." In short, the changes allowed for more and greater expansion of bank credit and the supply of money. Therefore, Taussig (1990, p. 415) concluded, "It is well nigh certain that eventually Congress will have to consider once more the further remodeling of the national bank system."

In fact, the Gold Standard Act of 1900 was only the opening gun of the banking reform movement. Three friends and financial journalists, two from Chicago, were to play a large role in the development of that movement. Massachusetts-born Charles A. Conant (1861–1915) a leading historian of banking, wrote his *A History of Modern Banks of Issue* in 1896, while still a Washington correspondent for the New York *Journal of Commerce* and an editor of *Bankers Magazine*. After his stint of public relations work and lobbying for the Indianapolis Convention, Conant moved to New York in 1902 to become treasurer of the Morgan-oriented Morton Trust Company. The two Chicagoans, both friends of Lyman Gage, were, along with Gage, in the Rockefeller ambit: Frank A. Vanderlip was picked by Gage as his assistant secretary of the treasury, and when Gage left office, Vanderlip came to New York as a top executive at the flagship commercial bank of the Rockefeller interests, the National City Bank of New York. Meanwhile, Vanderlip's close friend and former mentor at the *Chicago Tribune*, Joseph French Johnson, had also moved east to become professor of finance at the Wharton School of the University of Pennsylvania. But no sooner had the Gold Standard Act been passed when Joseph Johnson sounded the trump by calling for more fundamental reform.

Professor Johnson stated flatly that the existing bank note system was weak in not "responding to the needs of the money market," i.e., not supplying a sufficient amount of money. Since the national banking system was incapable of supplying those needs, Johnson opined, there was no reason to continue it. Johnson deplored the U.S. banking system as the worst in the world, and pointed to the glorious central banking system as existed in Britain and France.[6] But no such

[6]Joseph French Johnson (1900, pp. 482–507). Johnson, however, deplored the one fly in the Bank of England ointment—the remnant of the hard-money Peel's Act of 1844 that placed restrictions on the quantity of bank note issue (ibid., p. 496).

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centralized banking system yet existed in the United States: "In the United States, however, there is no single business institution, and no group of large institutions, in which self-interest, responsibility, and power naturally unite and conspire for the protection of the monetary system against twists and strains."

In short, there was far too much freedom and decentralization in the system. In consequence, our massive deposit credit system "trembles whenever the foundations are disturbed," i.e., whenever the chickens of inflationary credit expansion came home to roost in demands for cash or gold. The result of the inelasticity of money, and of the impossibility of interbank cooperation, Johnson opined, was that we were in danger of losing gold abroad just at the time when gold was needed to sustain confidence in the nation's banking system (Johnson 1900, pp. 497f).

After 1900, the banking community was split on the question of reform, the small and rural bankers preferring the status quo. But the large bankers, headed by A. Barton Hepburn of Morgan's Chase National Bank, drew up a bill as head of a commission of the American Bankers Association, and presented it in late 1901 to Representative Charles N. Fowler of New Jersey, chairman of the House Banking and Currency Committee, who had introduced one of the bills that had led to the Gold Standard Act. The Hepburn proposal was reported out of committee in April 1902 as the Fowler Bill (Kolko 1983, pp. 149–50).

The Fowler Bill contained three basic clauses.The first allowed the further expansion of national bank notes based on broader assets than government bonds. The second, a favorite of the big banks, was to allow national banks to establish branches at home and abroad, a step illegal under the existing system due to fierce opposition by the small country bankers. While branch banking is consonant with a free market and provides a sound and efficient system for calling on other banks for redemption, the big banks had little interest in branch banking unless accompanied by centralization of the banking system. Third, the Fowler Bill proposed to create a three-member board of control within the Treasury Department to supervise the creation of the new bank notes and to establish clearinghouse associations under its aegis. This provision was designed to be the first step toward the establishment of a fullfledged central bank (Livingston 1986, pp. 150–54).

Although they could not control the American Bankers Association, the multitude of country bankers, up in arms against the proposed competition of big banks in the form of branch banking, put fierce pressure upon Congress and managed to kill the Fowler Bill in the House during 1902, despite the agitation of the executive committee and staff of the Indianapolis Monetary Convention.

With the defeat of the Fowler Bill, the big bankers decided to settle for more modest goals for the time being. Senator Nelson W. Aldrich of Rhode Island, perennial Republican leader of the U.S. Senate and Rockefeller's man in Congress,[7] submitted

[7]Nelson W. Aldrich, who entered the Senate a moderately wealthy wholesale grocer and left years later a multimillionaire, was the father-in-law of John D. Rockefeller, Jr. His grandson and namesake, Nelson Aldrich Rockefeller, later became vice president of the United States, and head of the "corporate liberal" wing of the Republican party.

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the Aldrich Bill the following year, allowing the large national banks in New York to issue "emergency currency" based on municipal and railroad bonds. But even this bill was defeated.

Meeting setbacks in Congress, the big bankers decided to regroup and turn temporarily to the executive branch. Foreshadowing a later, more elaborate collaboration, two powerful representatives each from the Morgan and Rockefeller banking interests met with Comptroller of the Currency William B. Ridgely in January 1903, to try to persuade him, by administrative fiat, to restrict the volume of loans made by the country banks in the New York money market. The two Morgan men at the meeting were J.P. Morgan and George F. Baker, Morgan's closest friend and associate in the banking business.[8] The two Rockefeller men were Frank Vanderlip and James Stillman, long-time chairman of the board of the National City Bank.[9] The close Rockefeller–Stillman alliance was cemented by the marriage of the two daughters of Stillman to the two sons of William Rockefeller, brother of John D. Rockefeller, Sr., and long-time board member of the National City Bank (Burch 1981, pp. 134–35).

The meeting with the Comptroller did not bear fruit, but the lead instead was taken by the secretary of the treasury himself, Leslie Shaw, formerly presiding officer at the second Indianapolis Monetary Convention, whom President Roosevelt appointed to replace Lyman Gage. The unexpected and sudden shift from McKinley to Roosevelt in the presidency meant more than just a turnover of personnel; it meant a fundamental shift from a Rockefeller-dominated to a Morgan-dominated administration. In the same way, the shift from Gage to Shaw was one of the many Rockefeller-to-Morgan displacements.

On monetary and banking matters, however, the Rockefeller and Morgan camps were as one. Secretary Shaw attempted to continue and expand Gage's experiments in trying to make the Treasury function like a central bank, particularly in making open-market purchases in recessions, and in using Treasury deposits to bolster the banks and expand the money supply. Shaw violated the statutory institution of the independent Treasury, which had tried to confine government revenues and expenditures to its own coffers. Instead, he expanded the practice of depositing Treasury funds in favored, big national banks. Indeed, even banking reformers denounced the deposit of Treasury funds to pet banks as artificially lowering interest rates and leading to artificial expansion of credit. Furthermore, any government deficit would obviously throw a system dependent on a flow of new government revenues into chaos. All in all, the reformers agreed increasingly with the verdict of economist Alexander Purves, that "the uncertainty as to the

[8]Baker was head of the Morgan-dominated First National Bank of New York, and served as a director of virtually every important Morgan-run enterprise, including: Chase National Bank, Guaranty Trust Compay, Morton Trust Company, Mutual Life Insurance Company, AT&T, Consolidated Gas Company of New York, Erie Railroad, New York Central Railroad, Pullman Company, and United States Steel. See Burch (1981, pp. 190, 229).

[9]On the meeting, see Livingston (1986, p. 155).

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Secretary's power to control the banks by arbitrary decisions and orders, and the fact that at some future time the country may be unfortunate in its chief Treasury official [has] . . . led many to doubt the wisdom" of using the Treasury as a form of central bank (Livingston 1986, 156; Burch 1981, pp. 161–62). In his last annual report of 1906, Secretary Shaw urged that he be given total power to regulate all the nation's banks. But the game was up, and by then it was clear to the reformers that Shaw's as well as Gage's proto-central bank manipulations had failed. It was time to undertake a struggle for a fundamental legislative overhaul of the American banking system to bring it under central banking control.[10]

CHARLES A. CONANT: SURPLUS CAPITAL AND ECONOMIC IMPERIALISM

The years shortly before and after 1900 proved to be the beginnings of the drive toward the establishment of a Federal Reserve System. It was also the origin of the gold-exchange standard, the fateful system imposed upon the world by the British in the 1920s and by the United States after World War II at Bretton Woods. Even more than the case of a gold standard with a central bank, the gold-exchange standard establishes a system, in the name of gold, which in reality manages to install coordinated international inflationary paper money. The idea was to replace a genuine gold standard, in which each country (or, domestically, each bank) maintains its reserves in gold, by a pseudo-gold standard in which the central bank of the client country maintains its reserves in some key or base currency, say pounds, or dollars. Thus, during the 1920s, most countries maintained their reserves in pounds, and only Britain purported to redeem pounds in gold. This meant that these other countries were really on a pound rather than a gold standard, although they were able, at least temporarily, to acquire the prestige of gold. It also meant that when Britain inflated pounds, there was no danger of losing gold to these other countries, who, quite the contrary, happily inflated their own currencies on top of their expanding balances in pounds sterling. Thus, there was generated an unstable, inflationary system—all in the name of gold—in which client states pyramided their own inflation on top of Great Britain's. The system was eventually bound to collapse, as did the gold-exchange standard in the Great Depression and Bretton Woods by the late 1960s. In addition, the close ties based on pounds and then dollars meant that the key or base country was able to exert a form of economic imperialism, joined by their common paper and pseudo-gold inflation, upon the client states using the key money.

By the late 1890s, groups of theoreticians in the United States were working on what would later be called the "Leninist" theory of capitalist imperialism. The theory was originated, not by Lenin but by advocates of imperialism, centering around such Morgan-oriented friends and brain trusters of Theodore Roosevelt as Henry Adams, Brooks Adams, Admiral Alfred T. Mahan, and Massachusetts Senator

[10]On Gage and Shaw's manipulations, see Rothbard (1984, pp. 94–96) and Friedman and Schwartz (1963, pp. 148–56).

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Henry Cabot Lodge. The idea was that capitalism in the developed countries was "overproducing," not simply in the sense that more purchasing power was needed in recessions, but more deeply in that the rate of profit was therefore inevitably falling. The ever lower rate of profit from the "surplus capital" was in danger of crippling capitalism, except that salvation loomed in the form of foreign markets and especially foreign investments. New and expanded foreign markets would increase profits, at least temporarily, while investments in undeveloped countries would be bound to bring a high rate of profit. Hence, to save advanced capitalism, it was necessary for Western governments to engage in outright imperialist or neo-imperialist ventures, which would force other countries to open their markets for American products and would force open investment opportunities abroad.

Given this doctrine—based on the fallacious Ricardian view that the rate of profit is determined by the stock of capital investment, instead of by the time preferences of everyone in society—there was little for Lenin to change except to give an implicit moral condemnation instead of approval and to emphasize the necessarily temporary nature of the respite imperialism could furnish for capitalists.[11]

Charles Conant set forth the theory of surplus capital in his *A History of Modern Banks of Issue* (1896) and developed it in subsequent essays. The existence of fixed capital and modern technology, Conant claimed, invalidated Say's Law and the concept of equilibrium, and led to chronic "oversavings," which he defined as savings in excess of profitable investment outlets, in the developed Western capitalist world. Business cycles, claimed Conant, were inherent in the unregulated activity of modern industrial capitalism. Hence the importance of government-encouraged monopolies and cartels to stabilize markets and the business cycle, and in particular the necessity of economic imperialism to force open profitable outlets abroad for American and other Western surplus capital.

The United States's bold venture into an imperialist war against Spain in 1898 galvanized the energies of Conant and other theoreticians of imperialism. Conant responded with his call for imperialism in "The Economic Basis of Imperialism" in the September 1898 *North American Review*, and in other essays collected in *The United States in the Orient: The Nature of the Economic Problem* and published in 1900. S.J. Chapman (1901, p. 78), a distinguished British economist, accurately summarized Conant's argument as follows: (1) "In all advanced countries there has been such excessive saving that no profitable investment for capital remains." (2) Since all countries do not practice a policy of commercial freedom, "America must be prepared to use force if necessary" to open up profitable investment outlets abroad, and (3) the United States possesses an advantage in the coming

[11]Indeed, the adoption of this theory of the alleged necessity for imperialism in the "later stages" of capitalism went from pro-imperialists like the U.S. Investor, Charles A. Conant and Brooks Adams in 1898–1899, to the Marxist H. Gaylord Wilshire in 1900–1901, and in turn to the English left-liberal anti-imperialist John A. Hobson, who in turn influenced Lenin. See in particular Norman Etherington (1984; 1982, pp. 1–36).

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struggle, since the organization of many of its industries "in the form of trusts will assist it greatly in the fight for commercial supremacy."[12]

The war successfully won, Conant was particularly enthusiastic about the United States keeping the Philippines, the gateway to the great potential Asian market. The United States, he opined, should not be held back by "an abstract theory" to adopt "extreme conclusions" on applying the doctrines of the Founding Fathers on the importance of the consent of the governed. The Founding Fathers, he declared, surely meant that self-government could only apply to those competent to exercise it, a requirement that clearly did not apply to the backward people of the Philippines. After all, Conant wrote, "Only by the firm hand of the responsible governing races . . . can the assurance of uninterrupted progress be conveyed to the tropical and undeveloped countries" (Healy 1970, pp. 200–01).

Conant also was bold enough to derive important domestic conclusions from his enthusiasm for imperialism. Domestic society, he claimed, would have to be transformed to make the nation as "efficient" as possible. Efficiency, in particular, meant centralized concentration of power. "Concentration of power, in order to permit prompt and efficient action, will be an almost essential factor in the struggle for world empire." In particular, it was important for the United States to learn from the magnificent centralization of power and purpose in Czarist Russia. The government of the United States would require "a degree of harmony and symmetry which will permit the direction of the whole power of the state toward definite and intelligent policies." The U.S. Constitution would have to be amended to permit a form of Czarist absolutism, or at the very least an enormously expanded executive power in foreign affairs (Healy, pp. 202–03).

An interesting case study of business opinion energized and converted by the lure of imperialism was the Boston weekly, *The U.S. Investor*. Before the outbreak of war with Spain in 1898, the *U.S. Investor* denounced the idea of war as a disaster to business. But after the United States launched its war, and Commodore Dewey seized Manila Bay, the *Investor* totally changed its tune. Now it hailed the war as excellent for business, and as bringing about recovery from the previous recession. Soon the *Investor* was happily advocating a policy of "imperialism" to make U.S. prosperity permanent. Imperialism conveyed marvelous benefits to the country. At home, a big army and navy would be valuable in curbing the tendency of democracy to enjoy "a too great freedom from restraint, both of action and of thought." The *Investor* added that "European experience demonstrates that the army and navy are admirably adopted to inculcate orderly habits of thought and action."

But an even more important benefit from a policy of permanent imperialism is economic. To keep "capital . . . at work," stern necessity requires that "an enlarged field for its product must be discovered." Specifically, "a new field" had to be found for selling the growing flood of goods produced by the advanced nations, and for investment of their savings at profitable rates. The *Investor* exulted in the fact that

[12]See also Etherington (1984, p. 24).

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this new "field lies ready for occupancy. It is to be found among the semi-civilized and barbarian races," in particular the beckoning country of China.

Particularly interesting is the colloquy that ensued between the *Investor*, and the *Springfield* (Mass.) *Republican*, which still propounded the older theory of free trade and laissez-faire. The *Republican* asked why trade with undeveloped countries is not sufficient without burdening U.S. taxpayers with administrative and military overhead. The *Republican* also attacked the new theory of surplus capital, pointing out that only two or three years earlier businessmen had been loudly calling for more European capital to be invested in American ventures. To the first charge, the *Investor* fell back on "the experience of the race for, perhaps ninety centuries, [which] has been in the direction of foreign acquisitions as a means of national prosperity." But, more practically, the *Investor* delighted over the goodies that imperialism would bring to American business in the way of government contracts and the governmental development of what would now be called the "infrastructure" of the colonies. Furthermore, as in Britain, a greatly expanded diplomatic service would provide "a new calling for our young men of education and ability."

To the *Republican*'s second charge, on surplus capital, the *Investor*, like Conant, developed the idea of a new age that had just arrived in American affairs, an age of large-scale manufacture and hence overproduction, an age of a low rate of profit, and consequent formation of trusts in a quest for higher profits through suppression of competition. As the *Investor* put it, "The excess of capital has resulted in an unprofitable competition. To employ Franklin's witticism, the owners of capital are of the opinion they must hang together or else they will all hang separately." But while trusts may solve the problem of specific industries, they do not solve the great problem of a general "congestion of capital." Indeed, wrote the *Investor*, "finding employment for capital . . . is now the greatest of all economic problems that confront us."

To the *Investor*, the way out was clear:

> [T]he logical path to be pursued is that of the development of the natural riches of the tropical countries. These countries are now peopled by races incapable on their own initiative of extracting its full riches from their own soil . . . This will be attained in some cases by the mere stimulus of government and direction by men of the temperate zones; but it will be attained also by the application of modern machinery and methods of culture to the agricultural and mineral resources of the undeveloped countries. (quoted in Etherington 1984, p. 17)

By the spring of 1901, even the eminent economic theorist John Bates Clark of Columbia University was able to embrace the new creed. Reviewing pro-imperialist works by Conant, Brooks Adams, and the Reverend Josiah Strong in a single celebratory review in March 1901 in the *Political Science Quarterly*, Clark emphasized the importance of opening foreign markets and particularly of investing American capital "with an even larger and more permanent profit" (Parrini and Sklar 1983, p. 565, n. 16).

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J.B. Clark was not the only economist ready to join in apologia for the strong state. Throughout the land by the turn of the twentieth century, a legion of economists and other social scientists had arisen, many of them trained in graduate schools in Germany to learn of the virtues of the inductive method, the German Historical School, and a collectivist, organicist state. Eager for positions and power commensurate with their graduate training, these new social scientists, in the name of professionalism and technical expertise, prepared to abandon the old laissez-faire creed and take their places as apologists and planners in a new, centrally-planned state. Professor Edwin R.A. Seligman of Columbia University, of the prominent Wall Street investment banking family of J. and W. Seligman and Company, spoke for many of these social scientists when, in a presidential address before the American Economic Association in 1903, he hailed the "new industrial order."[13] Seligman prophesied that in the new, twentieth century, the possession of economic knowledge would grant economists the power "to control . . . and mold" the material forces of progress. As the economist proved able to forecast more accurately, he would be installed as "the real philosopher of social life," and the public would pay "deference to his views."

In his 1899 presidential address, Arthur Twining Hadley of Yale also saw economists developing as society's philosopher-kings. The most important application of economic knowledge, declared Hadley, was leadership in public life, becoming advisers and leaders of national policy. "I believe," opined Hadley,

> that their [economists'] largest opportunity in the immediate future lies not in theories but in practice, not with students but with statesmen, not in the education of individual citizens, however widespread and salutary, but in the leadership of an organized body politic. (Silva and Slaughter 1984, p. 103)

Hadley perceptively saw the executive branch of the government as particularly amenable to access of position and influence to economic advisers and planners. Previously, executives were hampered in seeking such expert counsel by the importance of political parties, their ideological commitments and their mass base in the voting population. But now, fortunately, the growing municipal reform (soon to be called the Progressive) movement was taking power away from political parties and putting it into the hands of administrators and experts. The "increased centralization of administrative power [was giving] . . . the expert a fair chance." And now, on the national scene, the new American leap into imperialism in the Spanish-American War was providing an opportunity for increased centralization, executive power, and therefore for administrative and expert planning. Even though Hadley declared himself personally opposed to imperialism, he urged economists to leap at this great opportunity for access to power (Silva and Slaughter 1984, pp. 120-21).

[13]Seligman was also related by marriage to the Loebs and to Paul Warburg of Kuhn, Loeb. Specifically, E.R.A. Seligman's brother, Isaac N. was married to Guta Loeb, sister of Paul Warburg's wife, Nina. See Stephen Birmingham (1977, appendix).

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The organized economic profession was not slow to grasp this new opportunity. Quickly, the executive and nominating committees of the American Economic Association (AEA) created a five-man special committee to organize and publish a volume on colonial finance. As Silva and Slaughter put it, this new, rapidly put together volume permitted the AEA to show the power elite

> how the new social science could serve the interests of those who made imperialism a national policy by offering technical solutions to the immediate fiscal problems of colonies as well as providing ideological justifications for acquiring them. (Silva and Slaughter, p. 133)

Chairman of the special committee was Professor Jeremiah W. Jenks of Cornell, the major economic adviser to Governor Theodore Roosevelt. Another member was Professor E.R.A. Seligman, another key adviser to Roosevelt. A third colleague was Dr. Albert Shaw, influential editor of the *Review of Reviews*, progressive reformer and social scientist, and long-time crony of Roosevelt's. All three were long-time leaders of the American Economic Association. The other two, non-AEA leaders, on the committee were Edward R. Strobel, former assistant secretary of state and adviser to colonial governments, and Charles S. Hamlin, wealthy Boston lawyer and assistant secretary of the treasury who had long been in the Morgan ambit, and whose wife was a member of the Pruyn family, longtime investors in two Morgan-dominated concerns: the New York Central Railroad and the Mutual Life Insurance Company of New York.

Essays in Colonial Finance (Jenks et al. 1900), the volume quickly put together by these five leaders, tried to advise the United States how best to run its newly-acquired empire. First, just as the British government insisted when the North American states were its colonies, the colonies should support their imperial government through taxation, whereas control should be tightly exercised by the United States imperial center. Second, the imperial center should build and maintain the economic infrastructure of the colony: canals, railroads, communications. Third, where—as was clearly anticipated—native labor is inefficient or incapable of management, the imperial government should import [white] labor from the imperial center. And, finally, as Silva and Slaughter put it,

> the committee's fiscal recommendations strongly intimated that trained economists were necessary for a successful empire. It was they who must make a thorough study of local conditions to determine the correct fiscal system, gather data, create the appropriate administrative design and perhaps even implement it. In this way, the committee seconded Hadley's views in seeing imperialism as an opportunity for economists by identifying a large number of professional positions best filled by themselves. (Silva and Slaughter 1984, p. 135)

With the volume written, the AEA cast about for financial support for its publication and distribution. The point was not simply to obtain the financing, but to do so in such a way as to gain the imprimatur of leading members of the power elite on this bold move for power to economists as technocratic expert advisers and administrators in the imperial nation-state.

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The American Economic Association found five wealthy businessmen to put up two-fifths the full cost of publishing *Essays in Colonial Finance*. By compiling the volume and then accepting corporate sponsors, several of whom had an economic stake in the new American empire, the AEA was signalling that the nation's organized economists were (1) wholeheartedly in favor of the new American empire; and (2) were willing and eager to play a strong role in advising and administering the empire, a role which they promptly and happily filled, as we shall see in the following section.

In view of the symbolic as well as practical role for the sponsors, a list of the five donors for the colonial finance volume is instructive. One was Isaac N. Seligman, head of the investment banking house of J and W Seligman and Company, a company with extensive overseas interests, especially in Latin America. Isaac's brother E.R.A. Seligman was a member of the special committee on Colonial Finance and an author of one of the essays in the volume. Another was William E. Dodge, a partner of the copper mining firm of Phelps, Dodge and Company, and member of a powerful mining family allied to the Morgans. A third donor was Theodore Marburg, an economist who was vice president of the AEA at the time, and also an ardent advocate of imperialism as well as heir to a substantial American Tobacco Company fortune. Fourth was Thomas Shearman, a single-taxer and an attorney for the powerful railroad magnate Jay Gould. And last but not least, was Stuart Wood, a manufacturer who had a Ph.D. in economics and had been a vice president of the AEA.

CONANT: MONETARY IMPERIALISM AND THE GOLD EXCHANGE STANDARD

The leap into political imperialism by the United States in the late 1890s was accompanied by economic imperialism, and one key to economic imperialism was monetary imperialism. In brief, the developed Western countries by this time were on the gold standard, while most of the Third World nations were on the silver standard. For the past several decades, the value of silver in relation to gold had been steadily falling, due to (1) an increasing world supply of silver relative to gold, and (2) the subsequent shift of many Western nations from silver or bimetallism to gold, thereby lowering the world's demand for silver as a monetary metal.

The fall of silver value meant monetary depreciation and inflation in the Third World, and it would have been a reasonable policy to shift from a silver-coin to a gold-coin standard. But the new imperialists among U.S. bankers, economists, and politicians were far less interested in the welfare of Third World countries than in foisting a monetary imperialism upon them. For not only would the economies of the imperial center and the client states then be tied together, but they would be tied in such a way that these economies could pyramid their own monetary and bank credit inflation on top of inflation in the United States. Hence, what the new imperialists set out to do was pressure or coerce Third World countries to adopt, not a genuine gold-coin standard, but a newly conceived "gold exchange" or dollar standard.

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Instead of silver currency fluctuating freely in terms of gold, the silver-gold rate would then be fixed by arbitrary government price-fixing. The silver countries would be silver in name only; the country's monetary reserve would be held, not in silver, but in dollars allegedly redeemable in gold; and these reserves would be held, not in the country itself, but as dollars piled up in New York City. In that way, if U.S. banks inflated their credit, there would be no danger of losing gold abroad, as would happen under a genuine gold standard. For under a true gold standard, no one and no country would be interested in piling up claims to dollars overseas. Instead, they would demand payment of dollar claims in gold. So that even though these American bankers and economists were all too aware, after many decades of experience, of the fallacies and evils of bimetallism, they were willing to impose a form of bimetallism upon client states in order to tie them into U.S. economic imperialism, and to pressure them into inflating their own money supplies on top of dollar reserves supposedly, but not *de facto* redeemable in gold.

The United States first confronted the problem of silver currencies in a Third World country when it seized control of Puerto Rico from Spain in 1898 and occupied it as a permanent colony. Fortunately for the imperialists, Puerto Rico was already ripe for currency manipulation. Only three years earlier, in 1895, Spain had destroyed the full-bodied Mexican silver currency that its colony had previously enjoyed, and replaced it with a heavily debased silver "dollar," worth only 41 cents in U.S. currency. The Spanish government had pocketed the large seigniorage profits from that debasement. The United States was therefore easily able to substitute its own debased silver dollar, worth only 45.6 cents in gold. Thus, the United States silver currency replaced an even more debased one, and also the Puerto Ricans had no tradition of loyalty to a currency only recently imposed by the Spaniards. There was therefore little or no opposition in Puerto Rico to the U.S. monetary takeover.[14]

The major controversial question was what exchange rate the American authorities would fix between the two debased coins: the old Puerto Rican silver peso and the U.S. silver dollar. This was the rate at which the U.S. authorities would compel the Puerto Ricans to exchange their existing coinage for the new American coins. The treasurer in charge of the currency reform for the U.S. government was the prominent Johns Hopkins economist, Jacob H. Hollander, who had been special commissioner to revise Puerto Rican tax laws, and who was one of the new breed of academic economists repudiating laissez-faire for comprehensive statism. The heavy debtors in Puerto Rico—mainly the large sugar planters—naturally wanted to pay their peso obligations at as cheap a rate as possible; they lobbied for a peso worth 50 cents American. In contrast, the Puerto Rican banker-creditors wanted the rate fixed at 75 cents. Since the exchange rate was arbitrary anyway, Hollander and the other American officials decided in the time-honored way of

[14]See the illuminating article by Emily S. Rosenberg (1985, pp. 172–73).

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governments: more or less splitting the difference, and fixing a peso equal to 60 cents.[15]

The Philippines, the other Spanish colony grabbed by the United States, posed a far more difficult problem. As in most of the Far East, the Philippines was happily using a perfectly sound silver currency, the Mexican silver dollar. But the United States was anxious for a rapid reform, because its large armed forces establishment suppressing Filipino nationalism required heavy expenses in U.S. dollars, which it of course declared to be legal tender for payments. Since the Mexican silver coin was also legal tender and was cheaper than the U.S. gold dollar, the U.S. military occupation found its revenues being paid in unwanted and cheaper Mexican coins.

Delicacy was required, and in 1901, for the task of currency takeover the Bureau of Insular Affairs [BIA] of the War Department—the agency running the U.S. occupation of the Philippines—hired Charles A. Conant for the task. Secretary of War Elihu Root was a redoubtable Wall Street lawyer in the Morgan ambit who sometimes served as J.P. Morgan's personal attorney. Root took a personal hand in sending Conant to the Philippines. Conant, fresh from the Indianapolis Monetary Commission and before going to New York as a leading investment banker, was, as might be expected, an ardent gold-exchange standard imperialist as well as the leading theoretician of economic imperialism.

Realizing that the Filipino people loved their silver coins, Conant devised a way to impose a gold U.S. dollar currency upon the country. Under his cunning plan, the Filipinos would continue to have a silver currency; but replacing the full-bodied Mexican silver coin would be an American silver coin tied to gold at a debased value far less than the market exchange value of silver in terms of gold. In this imposed, debased bimetallism, since the silver coin was deliberately overvalued in relation to gold by the U.S. government, Gresham's Law went inexorably into effect. The overvalued silver would keep circulating in the Philippines, and undervalued gold would be kept sharply out of circulation.

The seigniorage profit that the Treasury would reap from the debasement would be happily deposited at a New York bank, which would then function as a "reserve" for the U.S. silver currency in the Philippines. Thus, the New York funds would be used for payment outside the Philippines instead of as coin or specie. Moreover, the U.S. government could issue paper dollars based on its new reserve fund.

[15]Also getting their start in administering imperialism in Puerto Rico were economist and demographer W.H. Willcox of Cornell, who conducted the first census on the island as well as in Cuba in 1900, and Roland P. Falkner, statistician and bank reformer first at the University of Pennsylvania, and then head of the Division of Documents at the Library of Congress, who became commissioner of education in Puerto Rico in 1903. Falkner went on to head the U.S. Commission to Liberia in 1909 and to be a member of the Joint Land Commission of the U.S. and Chinese governments. Harvard economist Thomas S. Adams served as assistant treasurer to Hollander in Puerto Rico. Political scientist William F. Willoughby succeeded Hollander as treasurer (Silva and Slaughter 1984, pp. 137–38).

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It should be noted that Conant originated the gold exchange scheme as a way of exploiting and controlling Third-World economies based on silver. At the same time, Great Britain was introducing similar schemes in its colonial areas in Egypt, the Straits Settlements in Asia, and particularly in India.

Congress, however, pressured by the silver lobby, balked at the BIA's plan. And so the BIA again turned to the seasoned public relations and lobbying skills of Charles A. Conant. Conant swung into action. Meeting with editors of the top financial journals, he secured their promises to write editorials pushing for the Conant plan, many of which he obligingly wrote himself. He was already backed by the American banks of Manila. Recalcitrant U.S. bankers were warned by Conant that they could no longer expect large government deposits from the War Department if they continued to oppose the plan. Furthermore, Conant won the support of the major enemies of his plan, the American silver companies and pro-silver bankers, promising them that if the Philippine currency reform went through, the federal government would buy silver for the new U.S. coinage in the Philippines from these same companies. Finally, the tireless lobbying, and the mixture of bribery and threats by Conant, paid off. Congress passed the Philippine Currency Bill in March 1903.

In the Philippines, however, the United States could not simply duplicate the Puerto Rican example and coerce the conversion of the old for the new silver coinage. For the Mexican silver coin was a dominant coin not only in the Far East but throughout the world, and the coerced conversion would have been endless. The U.S. tried; it removed the legal tender privilege from the Mexican coins, and decreed the new U.S. coins to be used for taxes, government salaries, and other government payments. But this time the Filipinos happily used the old Mexican coins as money, while the U.S. silver coins disappeared from circulation into payment of taxes and transactions to the United States.

The War Department was beside itself: how could it drive Mexican silver coinage out of the Philippines? In desperation, it turned to the indefatigable Conant, but Conant couldn't join the colonial government in the Philippines because he had just been appointed to a more farflung presidential commission on international exchange for pressuring Mexico and China to go on a similar gold-exchange standard. Hollander, fresh from his Puerto Rican triumph, was ill. Who else? Conant, Hollander, and several leading bankers told the War Department they could recommend no one for the job, so new then was the profession of technical expert in monetary imperialism. But there was one more hope, the other pro-cartellist and financial imperialist, Cornell's Jeremiah W. Jenks, a fellow-member with Conant of President Roosevelt's new Commission on International Exchange [CIE]. Jenks had already paved the way for Conant by visiting English and Dutch colonies in the Far East in 1901 to gain information about running the Philippines. Jenks finally came up with a name, his former graduate student at Cornell, Edwin W. Kemmerer.

Young Kemmerer went to the Philippines from 1903 to 1906, to implement the Conant plan. Based on the theories of Jenks and Conant, and on his own

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experience in the Philippines, Kemmerer went on to teach at Cornell and then at Princeton, and gained fame throughout the 1920s as the "money doctor," busily imposing the gold-exchange standard on country after country abroad.

Relying on Conant's behind-the-scenes advice, Kemmerer and his associates finally came out with a successful scheme to drive out the Mexican silver coins. It was a plan that relied heavily on government coercion. The United States imposed a legal prohibition on the importation of the Mexican coins, followed by severe taxes on any private Philippine transactions daring to use the Mexican currency. Luckily for the planners, their scheme was aided by a large-scale demand at the time for Mexican silver in northern China, which absorbed silver from the Philippines or that would have been smuggled into the islands. The U.S. success was aided by the fact that the new U.S. silver coins, perceptively called "conants" by the Filipinos, were made up to look very much like the cherished old Mexican coins. By 1905, force, luck, and trickery had prevailed, and the conants (worth 50 cents in U.S. money) were the dominant currency in the Philippines. Soon the U.S. authorities were confident enough to add token copper coins and paper conants as well.[16]

By 1903, the currency reformers felt emboldened enough to move against the Mexican silver dollar throughout the world. In Mexico itself, U.S. industrialists who wanted to invest there pressured the Mexicans to shift from silver to gold, and they found an ally in powerful finance minister Jose Limantour. But tackling the Mexican silver peso at home would not be an easy task, for the coin was known and used throughout the world, particularly in China, where it formed the bulk of the circulating coinage. Finally, after three-way talks between United States, Mexican, and Chinese officials, the Mexicans and Chinese were induced to send identical notes to the U.S. Secretary of State, urging the United States to appoint financial advisers to bring about a currency reform and stabilized exchange rates with the gold countries (Parrini and Sklar 1983, pp. 573–77; Rosenberg 1985, p. 184).

These requests gave President Roosevelt, upon securing Congressional approval, the excuse to appoint in March 1903 a three-man Commission on International Exchange (CIE) to bring about currency reform in Mexico, China, and the rest of the silver-using world. The aim was "to bring about a fixed relationship

[16]See Rosenberg (1985, pp. 177–81). Other economists and social scientists helping to administer imperialism in the Philippines were: Carl C. Plehn of the University of California, who served as chief statistician to the Philippine Commission in 1900–1901, and Bernard Moses, historian, political scientist and economist at the University of California, an ardent advocate of imperialism who served on the Philippine Commission from 1901–1903, and then became an expert in Latin American affairs, joining in a series of Pan American conferences. Political scientist David P. Barrows became superintendent of schools in Manila and director of education for eight years, from 1901 to 1909. This experience ignited a lifelong interest in the military for Barrows, who, while a professor at Berkeley and a general in the California National Guard in 1934, led the troops that broke the San Francisco longshoremen's strike. During World War II, Barrows carried over his interest in coercion to help in the forced internment of Japanese Americans in concentration camps. On Barrows, see Silva and Slaughter (1984, pp. 137–38). On Moses, see Dorfman (1949, pp. 96–98).

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between the moneys of the gold standard countries and the present silver-using countries," in order to foster "export trade and investment opportunities" in the gold countries and economic development in the silver countries.

The three members of the CIE were old friends and like-minded colleagues. Chairman was Hugh H. Hanna, of the Indianapolis Monetary Commission, the others were his former chief aide at that Commission, Charles A. Conant, and Professor Jeremiah W. Jenks. Conant, as usual, was the major theoretician and finagler. He realized that major opposition to Mexico and China's shift to a gold standard would come from the important Mexican silver industry, and he devised a scheme to get European countries to purchase large amounts of Mexican silver to ease the pain of the shift.

In a trip to European nations in the summer of 1903, however, Conant and the CIE found the Europeans less than enthusiastic about making Mexican silver purchases as well as subsidizing U.S. exports and investments in China, a land whose market they too were coveting. In the United States, on the other hand, major newspapers and financial periodicals, prodded by Conant's public relations work, warmly endorsed the new currency scheme.

In the meantime, however, the United States faced similar currency problems in its two new Caribbean protectorates, Cuba and Panama. Panama was easy. The United States occupied the Canal Zone, and would be importing vast amounts of equipment to build the canal, and so it decided to impose the American gold dollar as the currency in the nominally independent Republic of Panama. While the gold dollar was the official currency of Panama, the United States imposed as the actual medium of exchange a new debased silver peso worth 50 cents. Fortunately, the new peso was almost the same in value as the old Colombian silver coin it forcibly displaced, and so, like Puerto Rico, the takeover could go without a hitch.

Among the U.S. colonies or protectorates, Cuba proved the toughest nut to crack. Despite all of Conant's ministrations, Cuba's currency remained unreformed. Spanish gold and silver coins, French coins, and U.S. currency all circulated side by side, freely fluctuating in response to supply and demand. Furthermore, similar to the pre-reformed Philippines, a fixed bimetallic exchange rate between the cheaper U.S., and the more valuable Spanish and French coins, led the Cubans to return cheaper U.S. coins to the U.S. customs authorities in fees and revenues.

Why then did Conant fail in Cuba? In the first place, strong Cuban nationalism resented U.S. plans for seizing control of their currency. Conant's repeated request in 1903 for a Cuban invitation for the CIE to visit the island, met stern rejections from the Cuban government. Moreover, the charismatic U.S. military commander in Cuba, Leonard Wood, wanted to avoid giving the Cubans the impression that plans were afoot to reduce Cuba to colonial status.

The second objection was economic. The powerful sugar industry in Cuba depended on exports to the United States, and a shift from depreciated silver to higher valued gold money would increase the cost of sugar exports, by an amount

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Leonard Wood estimated to be about 20 percent. While the same problem had existed for the sugar planters in Puerto Rico, American economic interests, in Puerto Rico and in other countries such as the Philippines, favored forcing formerly silver countries onto a gold-based standard so as to stimulate U.S. exports into those countries. In Cuba, on the other hand, there was increasing U.S. investment capital pouring into the Cuban sugar plantations, so that powerful and even dominant U.S. economic interests existed on the other side of the currency reform question. Indeed, by World War I, American investments in Cuban sugar reached the sum of $95 million.

Thus, when Charles Conant resumed his pressure for a Cuban gold-exchange standard in 1907, he was strongly opposed by U.S. Governor of Cuba, Charles Magoon, who raised the problem of a gold-based standard crippling the sugar planters. The CIE never managed to visit Cuba, and ironically, Charles Conant died in Cuba, in 1915, trying in vain to convince the Cubans of the virtues of the gold-exchange standard (Rosenberg 1985, pp. 186–88).

The Mexican shift from silver to gold was more gratifying to Conant, but here the reform was effected by Foreign Minister Limantour and his indigenous technicians, with the CIE taking a back seat. However, the success of this shift, in the Mexican Currency Reform Act of 1905, was assured by a world rise in the price of silver, starting the following year, which made gold coins cheaper than silver, with Gresham's Law bringing about a successful gold coin currency in Mexico. But the U.S. silver coinage in the Philippines ran into trouble because of the rise in the world silver price. Here, the U.S. silver currency in the Philippines was bailed out by coordinated action by the Mexican government, which sold silver in the Philippines to lower the value of silver sufficiently so that the conants could be brought back into circulation.[17]

But the big failure of Conant–CIE monetary imperialism was in China. In 1900, Britain, Japan, and the United States intervened in China to put down the Boxer Rebellion. The three countries thereupon forced defeated China to agree to pay them and all major European powers an indemnity of $333 million. The United States interpreted the treaty as an obligation to pay in gold, but China, on a depreciated silver standard, began to pay in silver in 1903, an action that enraged the three treaty powers. The U.S. minister to China reported that Britain might declare China's payment in silver a violation of the treaty, which would presage military intervention.

Emboldened by United States success in the Philippines, Panama, and Mexico, Secretary of War Root sent Jeremiah W. Jenks on a mission to China in early 1904 to try to transform China from a silver- to a gold-exchange standard. Jenks also

[17]It is certainly possible that one of the reasons for the outbreak of the nationalist Mexican Revolution of 1910, in part a revolution against U.S. influence, and was reaction against the U.S.-led currency manipulation and the coerced shift from silver to gold. Certainly, research needs to be done into this possibility.

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wrote to President Roosevelt from China urging that the Chinese indemnity to the United States from the Boxer Rebellion be used to fund exchange professorships for thirty years. Jenks's mission, however, was a total failure. The Chinese understood the CIE currency scheme all too well. They saw and denounced the seigniorage of the gold-exchange standard as an irresponsible and immoral debasement of Chinese currency, an act that would impoverish China while adding to the profits of U.S. banks where seigniorage reserve funds would be deposited. Moreover, the Chinese officials saw that shifting the indemnity from silver to gold would enrich the European governments at the expense of the Chinese economy. They also noted that the CIE scheme would establish a foreign controller of the Chinese currency to impose banking regulations and economic reforms on the Chinese economy. We need not wonder at the Chinese outrage. China's reaction was its own nationalistic currency reform in 1905, to replace the Mexican silver coin with a new Chinese silver coin, the tael (Rosenberg 1985, pp. 189–92).

Jenks's ignominious failure in China put an end to any formal role for the Commission on International Exchange.[18] An immediately following fiasco blocked the U.S. government's use of economic and financial advisers to spread the gold-exchange standard abroad. In 1905, the State Department hired Jacob Hollander to move another of its Latin American client states, the Dominican Republic, onto the gold-exchange standard. When Hollander accomplished this task by the end of the year, the State Department asked the Dominican government to hire Hollander to work out a plan for financial reform, including a U.S. loan, and a customs service run by the United States to collect taxes for repayment of the loan. Hollander, son-in-law of prominent Baltimore merchant Abraham Hutzler, used his connection with Kuhn, Loeb and Company to place Dominican bonds with that investment bank. Hollander also engaged happily in double dipping for the same work, collecting fees for the same job from the State Department and from the Dominican government. When this peccadillo was discovered in 1911, the scandal made it impossible for the U.S. government to use its own employees and its own funds to push for gold-exchange experts abroad. From then on, there was more of a public-private partnership between the U.S. government and the investment bankers, with the bankers supplying their own funds, and the State Department supplying good will and more concrete resources.

Thus, in 1911–1912, the United States, over great opposition, imposed a gold-exchange standard on Nicaragua. The State Department formally stepped aside, but approved Charles Conant's hiring by the powerful investment banking firm of Brown Brothers to bring about a loan and the currency reform. The State Department lent not only its approval to the project, but also its official wires, for

[18]The failure, however, did not diminish the U.S. government's demand for Jenks's services. He went on to advise the Mexican government, serve as a member of the Nicaraguan High Commission under President Wilson's occupation regime, and also headed the Far Eastern Bureau of the State Department (Silva and Slaughter 1989, pp. 136–37).

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Conant and Brown Brothers to conduct the negotiations with the Nicaraguan government.

By the time he died in Cuba in 1915, Charles Conant had made himself the chief theoretician and practitioner of the gold-exchange and the economic imperialist movements. Aside from his successes in the Philippines, Panama, and Mexico, and his failures in Cuba and China, Conant led in pushing for gold-exchange reform and gold-dollar imperialism in Liberia, Bolivia, Guatemala, and Honduras. His *magnum opus* in favor of the gold-exchange standard, the two-volume *The Principles of Money and Banking* (1905), as well as his pathbreaking success in the Philippines, were followed by a myriad of books, articles, pamphlets, and editorials, always backed up by his personal propaganda efforts.

Particularly interesting were Conant's arguments in favor of a gold-exchange, rather than a genuine gold-coin standard. A straight gold-coin standard, Conant believed, did not provide a sufficient amount of gold to provide for the world's monetary needs. Hence, by tying the existing silver standards in the undeveloped countries to gold, the "shortage" of gold could be overcome, and also the economies of the undeveloped countries could be integrated into those of the dominant imperial power. All this could only be done if the gold-exchange standard were "designed and implemented by careful government policy," but of course Conant himself and his friends and disciples always stood ready to advise and provide such implementation (Rosenberg 1985, p. 197).

In addition, adopting a government-managed gold-exchange standard was superior to either genuine gold or bimetallism because it left each state the flexibility of adapting its currency to local needs. As Conant asserted,

> It leaves each state free to choose the means of exchange which conform best to its local conditions. Rich nations are free to choose gold, nations less rich silver, and those whose financial methods are most advanced are free to choose paper.

It is interesting that for Conant, paper was the most "advanced" form of money. It is clear that the devotion to the gold standard of Conant and of his colleagues was only to a debased and inflationary standard, controlled and manipulated by the U.S. government, with gold really serving as a facade of allegedly hard-money.

And one of the critical forms of government manipulation and control in Conant's proposed system was the existence and active functioning of a central bank. As a founder of the "science" of financial advising to governments, Conant, followed by his colleagues and disciples, not only pushed a gold-exchange standard wherever he could do so, but also a central bank to manage and control that standard. As Emily Rosenberg points out:

> Conant thus did not neglect . . . one of the major revolutionary changes implicit in his system: a new, important role for a central bank as a currency stabilizer. Conant strongly supported the American banking reform that culminated in

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> the Federal Reserve System . . . and American financial advisers who followed Conant would spread central banking systems, along with gold-standard currency reforms, to the countries they advised. (Rosenberg 1985, p. 198)

Along with a managed gold-exchange standard would come, as replacement for the old free-trade, nonmanaged, gold-coin standard, a world of imperial currency blocs, which "would necessarily come into being as lesser countries deposited their gold stabilization funds in the banking systems of more advanced countries" (ibid.). New York and London banks, in particular, shaped up as the major reserve fundholders in the developing new world monetary order.

It is no accident that the U.S.'s major financial and imperial rival, Great Britain, which was pioneering in imposing gold-exchange standards in its own colonial area at this time, built upon this experience to impose a gold-exchange standard, marked by all European currencies pyramiding on top of British inflation, during the 1920s. That disastrous inflationary experiment led straight to the worldwide banking crash and the general shift to fiat paper moneys in the early 1930s. After World War II, the United States took up the torch of a world gold-exchange standard at Bretton Woods, with the dollar replacing the pound sterling in a worldwide inflationary system that lasted approximately twenty-five years.

Nor should it be thought that Charles A. Conant was the purely disinterested scientist he claimed to be. His currency reforms directly benefitted his investment banker employers. Thus, Conant was treasurer, from 1902 to 1906, of the Morgan-run Morton Trust Company of New York, and it was surely no coincidence that Morton Trust was the bank that held the reserve funds for the governments of the Philippines, Panama, and the Dominican Republic, after their respective currency reforms. In the Nicaragua negotiations, Conant was employed by the investment bank of Brown Brothers, and in pressuring other countries he was working for Speyer and Company and other investment bankers.

After Conant died in 1915, there were few to pick up the mantle of foreign financial advising. Hollander was in disgrace after the Dominican debacle. Jenks was aging, and lived in the shadow of his China failure, but the State Department did appoint Jenks to serve as a director of the Nicaraguan National Bank in 1917, and also hired him to study the Nicaraguan financial picture in 1925.

But the true successor of Conant was Edwin W. Kemmerer, the "money doctor." After his Philippine experience, Kemmerer joined his old Professor Jenks at Cornell, and then moved to Princeton in 1912, publishing his book *Modern Currency Reforms* in 1916. As the leading foreign financial adviser of the 1920s, Kemmerer not only imposed central banks and a gold-exchange standard on Third World countries, but also got them to levy higher taxes. Kemmerer, too, combined his public employment with service to leading international bankers. During the 1920s, Kemmerer worked as banking expert for the U.S. government's Dawes Commission, headed special financial advisory missions to over a dozen countries, and was kept on a handsome retainer by the distinguished investment banking firm of Dillon and Read from 1922 to 1929. In that era, Kemmerer and his

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mentor Jenks were the only foreign currency reform experts available for advising. In the late 1920s, Kemmerer helped establish a chair of international economics at Princeton, which he occupied, and from which he could train students like Arthur N. Young and William W. Cumberland. In the mid-1920s, the money doctor served as president of the American Economic Association.[19]

JACOB SCHIFF IGNITES THE DRIVE FOR A CENTRAL BANK

The defeat of the Fowler Bill for a broader asset-currency and branch banking in 1902, coupled with the failure of Secretary of Treasury Shaw's attempts of 1903–1905 to use the Treasury as a central bank, led the big bankers and their economist allies to adopt a new solution: the frank imposition of a central bank in the United States.

The campaign for a central bank was kicked off by a fateful speech in January 1906 by the powerful Jacob H. Schiff, head of the Wall Street investment bank of Kuhn, Loeb and Co., before the New York Chamber of Commerce. Schiff complained that, in the autumn of 1905, when "the country needed money," the Treasury, instead of working to expand the money supply, reduced government deposits in the national banks, thereby precipitating a financial crisis, a "disgrace" in which the New York clearinghouse banks had been forced to contract their loans drastically, sending interest rates sky-high. An "elastic currency" for the nation was therefore imperative, and Schiff urged the New York Chamber's committee on finance to draw up a comprehensive plan for a modern banking system to provide for an elastic currency (*Bankers Magazine* 1906, pp. 114–15). A colleague who had already been agitating for a central bank behind the scenes was Schiff's partner, Paul Moritz Warburg, who had suggested the plan to Schiff as early as 1903. Warburg had emigrated from the German investment firm of M.M. Warburg and Company in 1897, and before long his major function at Kuhn, Loeb was to agitate to bring the blessings of European central banking to the United States.[20]

It took less than a month for the finance committee of the New York Chamber to issue its report, but the bank reformers were furious, denouncing it as remarkably ignorant. When Frank A. Vanderlip, of Rockefeller's flagship bank, the National City Bank of New York, reported on this development, his boss, James Stillman, suggested that a new five-man special commission be set up by the New York Chamber to come back with a plan for currency reform.

In response, Vanderlip proposed that the five-man commission consist of himself, Schiff, J.P. Morgan, George Baker of the First National Bank of New York,

[19]For an excellent study of the Kemmerer missions in the 1920s see Seidel (1972, pp. 520–45).

[20]Schiff and Warburg were related by marriage. Schiff, from a prominent German banking family, was a son-in-law of Solomon Loeb, co-founder of Kuhn, Loeb; and Warburg, husband of Nina Loeb, was another son-in-law of Solomon Loeb's by a second wife. The incestuous circle was completed when Schiff's daughter Frieda married Paul Warburg's brother Felix, another partner of Schiff's and Paul Warburg's. See Birmingham (1977, pp. 21, 209–10, 383, appendix) and Attali (1986, p. 53).

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Morgan's closest and longest associate, and former Secretary of the Treasury Lyman Gage, now president of the Rockefeller-controlled U.S. Trust Company. Thus, the commission would consist of two Rockefeller men (Vanderlip and Gage), two Morgan men (Morgan and Baker), and one representative from Kuhn, Loeb. Only Vanderlip was available to serve, however, so the commission had to be redrawn. In addition to Vanderlip, beginning in March 1906, there sat, instead of Schiff, his close friend Isidore Straus, a director of R.H. Macy and Company. Instead of Morgan and Baker there now served two Morgan men: Dumont Clarke, president of the American Exchange National Bank and a personal adviser to J.P. Morgan and Charles A. Conant, treasurer of Morton and Company. The fifth man was a veteran of the Indianapolis Monetary Convention, John Claflin, of H.B. Claflin and Company, a large integrated wholesaling concern. Coming on board as secretary of the new currency committee was Vanderlip's old friend Joseph French Johnson, now of New York University, who had been calling for a central bank since 1900.

The commission used the old Indianapolis questionnaire technique: acquiring legitimacy by sending out a detailed questionnaire on currency to a number of financial leaders. With Johnson in charge of mailing and collating the questionnaire replies, Conant spent his time visiting and interviewing the heads of the central banks in Europe.

The special commission delivered its report to the New York Chamber in October, 1906. To eliminate instability and the danger of an inelastic currency, the commission called for the creation of a "central bank of issue under the control of the government." In keeping with other bank reformers, such as Professor Abram Piatt Andrew of Harvard University, Thomas Nixon Carver of Harvard, and Albert Strauss, partner of J.P. Morgan and Company, the commission was scornful of Secretary Shaw's attempt to use the Treasury as central bank. Shaw was particularly obnoxious because he was still insisting, in his last annual report of 1906, that the Treasury, under his aegis, had constituted a "great central bank." The commission, along with the other reformers, denounced the Treasury for overinflating by keeping interest rates excessively low; a central bank, in contrast, would have much larger capital and undisputed control over the money market, and thus would be able to manipulate the discount rate effectively to keep the economy under proper control. The important point, declared the committee, is that there be "centralization of financial responsibility." In the meantime, short of establishing a central bank, the committee urged that, at the least, the national bank's powers to issue notes be expanded to include being based on general assets as well as government bonds (Livingston 1986, pp. 159–64).

After drafting and publishing this "Currency Report," the reformers used the report as the lever for expanding the agitation for a central bank and broader note issue powers to other corporate and financial institutions. The next step was the powerful American Bankers Association (ABA). In 1905, the executive council of the ABA had appointed a currency committee which, the following year, recommended

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an emergency assets-currency that would be issued by a federal commission, resembling an embryonic central bank. In a tumultuous plenary session of the ABA convention in October, 1906, the ABA rejected this plan, but agreed to appoint a fifteen-man currency commission that was instructed to meet with the New York Chamber currency committee and attempt to agree on appropriate legislation.

Particularly prominent on the ABA currency commission were:

(1) Arthur Reynolds, president of the Des Moines National Bank, close to the Morgan-oriented Des Moines Regency, and brother of the prominent Chicago banker, George M. Reynolds, formerly of Des Moines and then president of the Morgan-oriented Continental National Bank of Chicago and the powerful chairman of the executive council of the ABA;

(2) James B. Forgan, president of the Rockefeller-run First National Bank of Chicago, and close friend of Jacob Schiff of Kuhn, Loeb, as well as of Vanderlip;

(3) Joseph T. Talbert, vice president of the Rockefeller-dominated Commercial National Bank of Chicago, and soon to become vice president of Rockefeller's flagship bank, the National City Bank of New York;

(4) Myron T. Herrick, one of the most prominent Rockefeller politicians and businessmen in the country. Herrick was the head of the Cleveland Society of Savings, and was one of the small team of close Rockefeller business allies who, along with Mark Hanna, bailed out Governor William McKinley from bankruptcy in 1893. Herrick was a previous president of the ABA, and had just finished a two-year stint as Governor of Ohio, and was later to become Ambassador to France under his old friend and political ally William Howard Taft as well as later under President Warren G. Harding, also a recipient of Herrick's political support and financial largesse; and

(5) Chairman of the ABA commission was A. Barton Hepburn, president of one of the leading Morgan commercial banks, the Chase National Bank of New York, and author of the well-regarded *History of Coinage and Currency in the United States.*

After meeting with Vanderlip and Conant as the representatives from the New York Chamber committee, the ABA commission, along with Vanderlip and Conant, agreed on at least the transition demands of the reformers. The ABA commission presented proposals to the public, the press, and the Congress in December 1906, for a broader asset currency as well as provisions for emergency issue of banknotes by national banks.

But just as sentiment for a broader-assets currency became prominent, the bank reformers began to worry about an uncontrolled adoption of such a currency. For that would mean that national bank credit and notes would expand, and that, in the existing system, small state banks would be able to pyramid and inflate credit on top of the national credit, using the expanded national bank notes as their reserves. The reformers wanted a credit inflation controlled by and confined to the large national banks; they most emphatically did not want uncontrolled state bank

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inflation that would siphon resources to small entrepreneurs and "speculative" marginal producers. The problem was aggravated by the accelerated rate of increase in the number of small southern and western state banks after 1900. Another grave problem for the reformers was that commercial paper was a different system from that of Europe. In Europe commercial paper, and hence bank assets, were two-name notes endorsed by a small group of wealthy acceptance banks. In contrast to this acceptance paper system, commercial paper in the United States was unendorsed single-name paper, with the bank taking a chance on the creditworthiness of the business borrower. Hence, a decentralized financial system in the United States was not subject to big-banker control.

Worries about the existing system and hence about uncontrolled asset currency were voiced by the top bank-reformers. Thus, Vanderlip expressed concern that "there are so many state banks that might count these [national bank] notes in their reserves." Schiff warned that "it will prove unwise, if not dangerous, to clothe six thousand banks or more with the privilege to issue independently a purely credit currency." And, from the Morgan side, a similar concern was voiced by Victor Morawetz, the powerful chairman of the board of the Atchison, Topeka and Santa Fe Railroad (Livingston 1986, pp. 168–69).

Taking the lead in approaching this problem of small banks and decentralization was Paul Moritz Warburg, of Kuhn, Loeb, fresh from his banking experience in Europe. In January 1907, Warburg began years of tireless agitation for central banking with two articles, "Defects and Needs of our Banking System," and "A Plan for a Modified Central Bank."[21] Calling openly for a central bank, Warburg pointed out that one of the important functions of such a bank would be to restrict the eligibility of bank assets to be used for expansion of bank deposits. Presumably, too, the central bank could move to require banks to use acceptance paper or otherwise try to create an acceptance market in the United States.[22]

By the summer of 1907, the *Bankers Magazine* was reporting a decline in influential banker support for broadening asset-currency and a strong move toward the "central bank project." *Bankers Magazine* (1907, pp. 314–15) noted as a crucial reason the fact that asset currency would be expanding bank services to "small producers and dealers."

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[21]See the collection of Warburg's essays in Paul M. Warburg (1930; 1914, pp. 387–612).

[22]When the Federal Reserve System was established, Warburg boasted of his crucial role in persuading the Fed to create an acceptance market in the United States by agreeing to purchase all acceptance paper available from a few large acceptance banks at subsidized rates. In that way, the Fed provided an unchecked channel for inflationary credit expansion. The acceptance program helped pave the way for the 1929 crash.

It was surely no accident that Warburg himself was the principal beneficiary of this policy. Warburg became Chairman of the Board, from its founding in 1920, of the International Acceptance Bank, the world's largest acceptance bank, as well as director of the Westinghouse Acceptance Bank and of several other acceptance houses. In 1919, Warburg was the chief founder and chairman of the executive committee of the American Acceptance Council, the trade association of acceptance houses. See Rothbard (1983, pp. 119–23).

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THE PANIC OF 1907 AND MOBILIZATION FOR A CENTRAL BANK

A severe financial crisis, the Panic of 1907, struck in early October. Not only was there a general recession and contraction, but the major banks in New York and Chicago were, as in most other depressions in American history, allowed by the government to suspend specie payments; that is, to continue in operation while being relieved of their contractual obligation to redeem their notes and deposits in cash or in gold. While the Treasury had stimulated inflation during 1905–1907, there was nothing it could do to prevent suspensions of payment, or to alleviate "the competitive hoarding of currency" after the panic; that is, the attempt to demand cash in return for increasingly shaky bank notes and deposits.

Very quickly after the panic, banker and business opinion consolidated on behalf of a central bank, an institution that could regulate the economy and serve as a lender of last resort to bail banks out of trouble. The reformers now faced a two-fold task: hammering out details of a new central bank, and more importantly, mobilizing public opinion on its behalf. The first step in such mobilization was to win the support of the nation's academics and experts. The task was made easier by the growing alliance and symbiosis between academia and the power elite. Two organizations that proved particularly useful for this mobilization were the American Academy of Political and Social Science (AAPSS) of Philadelphia, and the Academy of Political Science (APS) of Columbia University, both of which included in their ranks leading corporate liberal businessmen, financiers, attorneys, and academics. Nicholas Murray Butler, the highly influential president of Columbia University, explained that the Academy of Political Science "is an intermediary between . . . the scholars and the men of affairs, those who may perhaps be said to be amateurs in scholarship." Here, he pointed out, is where they "come together" (Livingston 1986, p. 175n).

It is not surprising, then, that the American Academy of Political and Social Science, the American Association for the Advancement of Science (AAAS), and Columbia University held three symposia during the winter of 1907–1908, each calling for a central bank, and thereby disseminating the message of a central bank to a carefully selected elite public. Not surprising, too, E.R.A. Seligman was the organizer of the Columbia conference, gratified that his university was providing a platform for leading bankers and financial journalists to advocate a central bank, especially, he added, because "it is proverbially difficult in a democracy to secure a hearing for the conclusions of experts." Then in 1908 Seligman collected the addresses into a volume, *The Currency Problem.*

Professor Seligman set the tone for the gathering in his opening address. The Panic of 1907, he alleged, was moderate because its effects had been tempered by the growth of industrial trusts, which provided a more controlled and "more correct adjustment of present investment to future needs" than would a "horde of small competitors." In that way, Seligman displayed no comprehension of how competitive markets facilitate adjustments. One big problem, however, still remained for

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Seligman. The horde of small competitors, for whom Seligman had so much contempt, still prevailed in the field of currency and banking. The problem was that the banking system was still decentralized. As Seligman declared, "Even more important than the inelasticity of our note issue is its decentralization. The struggle which has been victoriously fought out everywhere else [in creating trusts] must be undertaken here in earnest and with vigor" (Livingston 1986, p. 177).

The next address was that of Frank Vanderlip. To Vanderlip, in contrast to Seligman, the Panic of 1907 was "one of the great calamities of history"—the result of a decentralized, competitive American banking system, with fifteen thousand banks all competing vigorously for control of cash reserves. The terrible thing is that "each institution stands alone, concerned first with its own safety, and using every endeavor to pile up reserves without regard" to the effect of such actions on other banking institutions. This backward system must be changed, to follow the lead of other great nations, where a central bank is able to mobilize and centralize reserves, and create an elastic currency system. Putting the situation in virtually Marxian terms, Vanderlip declared that the alien external power of the free and competitive market must be replaced by central control following modern, allegedly scientific principles of banking.

Thomas Wheelock, editor of the *Wall Street Journal*, then rung the changes on the common theme by applying it to the volatile call loan market in New York. The market is volatile, Wheelock claimed, because the small country banks are able to lend on that market, and their deposits in New York banks then rise and fall in uncontrolled fashion. Therefore, there must be central corporate control over country bank money in the call loan market.

A. Barton Hepburn, head of Morgan's Chase National Bank, came next, and spoke of the great importance of having a central bank that would issue a monopoly of bank notes. It was particularly important that the central bank be able to discount the assets of national banks, and thus supply an elastic currency.

The last speaker was Paul Warburg, who lectured his audience on the superiority of European over American banking, particularly in (1) having a central bank, as against decentralized American banking; and (2)—his old hobby horse—enjoying "modern" acceptance paper instead of single-name promissory notes. Warburg emphasized that these two institutions must function together. In particular, tight government central bank control must replace competition and decentralization: "Small banks constitute a danger."

The other two symposia were very similar. At the AAPSS symposium in Philadelphia, in December 1907, several leading investment bankers and Comptroller of the Currency William B. Ridgely came out in favor of a central bank. It was no accident that members of the AAPSS's advisory committee on currency included A. Barton Hepburn; Morgan attorney and statesman Elihu Root; Morgan's long-time personal attorney Francis Lynde Stetson; and J.P. Morgan himself. Meanwhile the AAAS symposium in January 1908 was organized by none other than Charles A. Conant, who happened to be chairman of the AAAS's social and

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economic section for the year. Speakers included Columbia economist J.B. Clark, Frank Vanderlip, Conant, and Vanderlip's friend George E. Roberts, head of the Rockefeller-oriented Commercial National Bank of Chicago, who would later wind up at the National City Bank.

All in all, the task, of the bank reformers was well summed up by J.R. Duffield, secretary of the Bankers Publishing Company, in January 1908: "It is recognized generally that before legislation can be had there must be an educational campaign carried on, first among the bankers, and later among commercial organizations, and finally among the people as a whole." That strategy was well under way.

During the same month, the legislative lead in banking reform was taken by the formidable Senator Nelson W. Aldrich, (Republican, Rhode Island), head of the Senate Finance Committee, and, as the father-in-law of John D. Rockefeller, Jr., Rockefeller's man in the U.S. Senate. He introduced the Aldrich Bill, which focused on a relatively minor interbank dispute about whether and on what basis the national banks could issue special emergency currency. A compromise was finally hammered out and passed, as the Aldrich-Vreeland Act, in 1908.[23] But the important part of the Aldrich-Vreeland Act, which got very little public attention, but was perceptively hailed by the bank reformers, was the establishment of a National Monetary Commission that would investigate the currency question and suggest proposals for comprehensive banking reform. Two enthusiastic comments on the Monetary Commission were particularly perceptive and prophetic. One was that of Sereno S. Pratt of the *Wall Street Journal*. Pratt virtually conceded that the purpose of the commission was to swamp the public with supposed expertise and thereby "educate" them into supporting banking reform:

> Reform can only be brought about by educating the people up to it, and such education must necessarily take much time. In no other way can such education be effected more thoroughly and rapidly than by means of a commission . . . [that] would make an international study of the subject and present an exhaustive report, which could be made the basis for an intelligent agitation.

The results of the "study" were of course predetermined, as would be the membership of the allegedly impartial study commission.

Another function of the commission, as stated by Festus J. Wade, St. Louis banker and member of the currency commission of the American Bankers Association, was to "keep the financial issue out of politics" and put it squarely in the safe custody of carefully selected "experts" (Livingston 1986, pp. 182-83). Thus the National Monetary Commission was the apotheosis of the clever commission concept, launched in Indianapolis a decade earlier.

Aldrich lost no time setting up the National Monetary Commission (NMC), which was launched in June 1908. The official members were an equal number of

[23]The emergency currency provision was only used once, shortly before the provision expired, in 1914, after the establishment of the Federal Reserve System.

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Senators and Representatives, but these were mere window dressing. The real work would be done by the copious staff, appointed and directed by Aldrich, who told his counterpart in the House, Cleveland Republican Theodore Burton: "My idea is, of course, that everything shall be done in the most quiet manner possible, and without any public announcement." From the beginning, Aldrich determined that the NMC would be run as an alliance of Rockefeller, Morgan, and Kuhn, Loeb people. The two top expert posts advising or joining the commission were both suggested by Morgan leaders. On the advice of J.P. Morgan, seconded by Jacob Schiff, Aldrich picked as his top adviser the formidable Henry P. Davison, Morgan partner, founder of Morgan's Bankers' Trust Company, and vice president of George F. Baker's First National Bank of New York. It would be Davison who, on the outbreak of World War I, would rush to England to cement J.P. Morgan and Company's close ties with the Bank of England, and to receive an appointment as monopoly underwriter for all British and French government bonds to be floated in the United States for the duration of the war. For technical economic expertise, Aldrich accepted the recommendation of President Roosevelt's close friend and fellow Morgan man, Charles Eliot, president of Harvard University, who urged the appointment of Harvard economist A. Piatt Andrew. And an *ex-officio* commission member chosen by Aldrich himself was George M. Reynolds, president of the Rockefeller-oriented Continental National Bank of Chicago.

The NMC spent the fall touring Europe and conferring on information and strategy with heads of large European banks and central banks. As director of research, A. Piatt Andrew began to organize American banking experts and to commission reports and studies. The National City Bank's foreign exchange department was commissioned to write papers on bankers' acceptances and foreign debt, while Warburg and Bankers Trust official Fred Kent wrote on the European discount market.

Having gathered information and advice in Europe in the fall of 1908, the NMC was ready to go into high gear by the end of the year. In December, the commission hired the inevitable Charles A. Conant for research, public relations, and agitprop. Behind the facade of the Congressmen and Senators on the commission, Senator Aldrich began to form and expand his inner circle, which soon included Warburg and Vanderlip. Warburg formed around him a subcircle of friends and acquaintances from the currency committee of the New York Merchants' Association, headed by Irving T. Bush, and from the top ranks of the American Economic Association, to whom he had delivered an address advocating central banking in December 1908. Warburg met and corresponded frequently with leading academic economists advocating banking reform, including E.R.A. Seligman; Thomas Nixon Carver of Harvard; Henry R. Seager of Columbia; Davis R. Dewey, historian of banking at M.I.T., long-time secretary-treasurer of the AEA and brother of the progressive philosopher John Dewey; Oliver M.W. Sprague, professor of banking at Harvard, of the Morgan-connected Sprague family; Frank W. Taussig of Harvard; and Irving Fisher of Yale.

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During 1909, however, the reformers faced an important problem: they had to bring such leading bankers as James B. Forgan, head of the Rockefeller-oriented First National Bank of Chicago, solidly into line in support of a central bank. It was not that Forgan objected to centralized reserves or a lender of last resort—quite the contrary. It was rather that Forgan recognized that, under the National Banking System, large banks such as his own were already performing quasi-central banking functions with their own country bank depositors; and he didn't want his bank deprived of such functions by a new central bank.

The bank reformers therefore went out of their way to bring such men as Forgan into enthusiastic support for the new scheme. In his presidential address to the powerful American Bankers Association in mid-September, 1909, George M. Reynolds not only came out flatly in favor of a central bank in America, to be modeled after the German *Reichsbank*; he also assured Forgan and others that such a central bank would act as depository of reserves only for the large national banks in the central reserve cities, while the national banks would continue to hold deposits for the country banks. Mollified, Forgan held a private conference with Aldrich's inner circle and came fully on board for the central bank. As an outgrowth of Forgan's concerns, the reformers decided to cloak their new central bank in a spurious veil of "regionalism" and "decentralism" through establishing regional reserve centers, which would provide the appearance of virtually independent regional central banks to cover the reality of an orthodox European central bank monolith. As a result, noted railroad attorney Victor Morawetz made his famous speech in November 1909, calling for regional banking districts under the ultimate direction of one central control board. Thus, reserves and note issue would be supposedly decentralized in the hands of the regional reserve banks, while they would really be centralized and coordinated by the central control board. This, of course, was the scheme eventually adopted in the Federal Reserve System.[24]

On September 14, at the same time as Reynolds's address to the nation's bankers, another significant address took place. President William Howard Taft, speaking in Boston, suggested that the country seriously consider establishing a central bank. Taft had been close to the reformers—especially his Rockefeller-oriented friends Aldrich and Burton—since 1900. But the business press understood the great significance of this public address, that it was, as the *Wall Street Journal* put it, a crucial step, "towards removing the subject from the realm of theory to that of practical politics" (quoted in Livingston 1986, p. 191).

[24]Victor Morawetz was an eminent attorney in the Morgan ambit, who served as chairman of the executive committee of the Morgan-run Atchison, Topeka and Santa Fe Railway, and member of the board of the Morgan-dominated National Bank of Commerce. In 1908, Morawetz, along with J.P. Morgan's personal attorney, Francis Lynde Stetson, had been the principal drafter of an unsuccessful Morgan-National Civic Federation bill for a federal incorporation law to regulate and cartelize American corporations. Later, Morawetz was to be a top consultant to another "progressive" reform of Woodrow Wilson's, the Federal Trade Commission. On Morawetz, see Rothbard (1984, p. 99).

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One week later, a fateful event in American history occurred. The banking reformers moved to escalate their agitation by creating a virtual government-bank-press complex to drive through a central bank. On September 22, 1909, the *Wall Street Journal* took the lead in this development by beginning a notable, front-page, fourteen-part series on "A Central Bank of Issue." These were unsigned editorials by the *Journal*, but they were actually written by the ubiquitous Charles A. Conant, from his vantage point as salaried chief propagandist of the U.S. government's National Monetary Commission. The series was a summary of the reformers' position, also going out of the way to assure the Forgans of this world that the new central bank "would probably deal directly only with the larger national banks, leaving it for the latter to rediscount for their more remote correspondents" (ibid). To the standard arguments for the central bank: "elasticity" of the money supply, protecting bank reserves by manipulating the discount rate and the international flow of gold, and combating crisis by bailing out individual banks, Conant added a Conant-twist: the importance of regulating interest rates and the flow of capital in a world marked by surplus capital. Government debt would, for Conant, provide the important function of sopping up surplus capital; that is, providing profitable outlets for savings by financing government expenditures.

The *Wall Street Journal* series inaugurated a shrewd and successful campaign by Conant to manipulate the nation's press and get it behind the idea of a central bank. Building on his experience in 1898, Conant, along with Aldrich's secretary, Arthur B. Shelton, prepared abstracts of commission materials for the newspapers during February and March of 1910. Soon Shelton recruited J.P. Gavitt, head of the Washington bureau of the Associated Press, to scan commission abstracts, articles and forthcoming books for "newsy paragraphs" to catch the eye of newspaper editors.

The academic organizations proved particularly helpful to the NMC, lending their cloak of disinterested expertise to the endeavor. In February, Robert E. Ely, the secretary of the APS, proposed to Aldrich that a special volume of its *Proceedings* be devoted to banking and currency reform, to be published in cooperation with the NMC, in order to "popularize in the best sense, some of the valuable work of [the] Commission" (quoted in Livingston 1986, p. 194).

And yet, Ely had the gall to add that, even though the APS would advertise the NMC's arguments and conclusions, it would retain its "objectivity" by avoiding its own specific policy recommendations. As Ely put it, "We shall not advocate a central bank, but we shall only give the best results of your work in condensed form and untechnical language."

The AAPSS, too, weighed in with its own special volume, *Banking Problems* (1910), featuring an introduction by A. Piatt Andrew of Harvard and the NMC, and articles by veteran bank reformers such as Joseph French Johnson, Horace White, and Morgan Bankers Trust official Fred I. Kent. But most of the articles were from leaders of Rockefeller's National City Bank of New York, including George E. Roberts, former Chicago banker and U.S. Mint official about to join National City.

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Meanwhile, Paul M. Warburg capped his lengthy campaign for a central bank in a famous speech to the New York YMCA on March 23, on "A United Reserve Bank for the United States." Warburg basically outlined the structure of his beloved German *Reichsbank*, but he was careful to begin his talk by noting a recent poll in the *Banking Law Journal* that 60 percent of the nation's bankers favored a central bank provided it was "not controlled by 'Wall Street' or any monopolistic interest." To calm this fear, Warburg insisted that, semantically, the new Reserve Bank not be called a central bank, and that the Reserve Bank's governing board be chosen by government officials, merchants and bankers—with bankers, of course, dominating the choices. He also provided a distinctive Warburg-twist by insisting that the Reserve Bank replace the hated single-name paper system of commercial credit dominant in the United States, by the European system whereby a reserve bank provided a guaranteed and subsidized market for two-named commercial paper endorsed by acceptance banks. In this way, the United Reserve Bank would correct the "complete lack of modern bills of exchange [i.e., acceptances]" in the United States. Warburg added that the entire idea of a free and self-regulating market was obsolete, particularly in the money market. Instead, the action of the market must be replaced by "the best judgment of the best experts." And guess who was slated to be one of the best of those best experts?

The greatest cheerleader for the Warburg plan, and the man who introduced Warburg's volume on banking reform (1911) was his kinsman and member of the Seligman investment banking family, Columbia economist E.R.A. Seligman (Rothbard 1984, pp. 98–99; Livingston 1986, pp. 194–98).

So delighted was the Merchants' Association of New York with Warburg's speech that it distributed thirty-thousand copies during the spring of 1910. Warburg had paved the way for this support by regularly meeting with the currency committee of the Merchants Association since October 1908, and his efforts were aided by the fact that the resident expert for the merchants committee was none other than Joseph French Johnson.

At the same time, in the spring of 1910, the numerous research volumes published by the NMC poured onto the market. The object was to swamp public opinion with a parade of impressive analytic and historical scholarship, all allegedly "scientific" and "value-free," but all designed to aid in furthering the common agenda of a central bank. Typical was E.W. Kemmerer's mammoth statistical study of seasonal variations in the demand for money. Emphasis was placed on the problem of the "inelasticity" of the supply of cash, in particular the difficulty of expanding that supply when needed. While Kemmerer felt precluded from spelling out the policy implications—establishing a central bank—in the book, his acknowledgments in the preface to Fred Kent and the inevitable Charles Conant were a tip-off to the cognoscenti, and Kemmerer himself disclosed them in his address to the Academy of Political Science the following November.

Now that the theoretical and scholarly groundwork had been laid, by the latter half of 1910, it was time to formulate a concrete practical plan and put on a mighty

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putsch on its behalf. In the book on *Reform of the Currency* published by the APS, Warburg made the point with crystal clarity: "Advance is possible only by outlining a tangible plan" that would set the terms of the debate from then on (ibid., p. 203).

The tangible plan phase of the central bank movement was launched by the ever pliant APS, which held a monetary conference in November 1910, in conjunction with the New York Chamber of Commerce and the Merchants' Association of New York. The members of the NMC were the guests of honor at this conclave, and delegates were chosen by governors of twenty-two states, as well as presidents of twenty-four chambers of commerce. Also attending were a large number of economists, monetary analysts, and representatives of most of the top banks in the country. Attendants at the conference included Frank Vanderlip, Elihu Root, Thomas W. Lamont of the Morgans, Jacob Schiff, and J.P. Morgan. The formal sessions of the conference were organized around papers by Kemmerer, Laughlin, Johnson, Bush, Warburg, and Conant, and the general atmosphere was that bankers and businessmen were to take their general guidance from the attendant scholars. As James B. Forgan, Chicago banker who was now solidly in the central banking camp, put it: "Let the theorists, those who . . . can study from past history and from present conditions the effect of what we are doing, lay down principles for us, and let us help them with the details." C. Stuart Patterson pointed to the great lessons of the Indianapolis Monetary Commission, and the way in which its proposals triumphed in action because "we went home and organized an aggressive and active movement." Patterson then laid down the marching orders of what this would mean concretely for the assembled troops: "That is just what you must do in this case, you must uphold the hands of Senator Aldrich. You have got to see that the bill which he formulates . . . obtains the support of every part of this country" (Livingston 1986, pp. 205–07).

With the New York monetary conference over, it was now time for Aldrich, surrounded by a few of the topmost leaders of the financial elite, to go off in seclusion and hammer out a detailed plan around which all parts of the central bank movement could rally. Someone in the Aldrich inner circle, probably Morgan partner Henry P. Davison, got the idea of convening a small group of top leaders in a super-secret conclave to draft the central bank bill. On November 22, 1910, Senator Aldrich, with a handful of companions, set forth in a privately chartered railroad car from Hoboken, New Jersey to the coast of Georgia, where they sailed to an exclusive retreat, the Jekyll Island Club. Facilities for their meeting were arranged by club member and co-owner J.P. Morgan. The cover story released to the press was that this was a simple duck-hunting expedition, and the conferees took elaborate precautions on the trips there and back to preserve their secrecy. Thus, the attendees addressed each other only by first name, and the railroad car was kept dark and closed off from reporters or other travellers on the train. One reporter apparently caught on to the purpose of the meeting, but was in some way persuaded by Henry P. Davison to maintain silence.

The conferees worked for a solid week at Jekyll Island to hammer out the draft of the Federal Reserve bill. In addition to Aldrich, the conferees included Henry P.

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Davison, Morgan partner; Paul Warburg, whose address in the spring had greatly impressed Aldrich; Frank A. Vanderlip, vice-president of the National City Bank of New York; and finally, A. Piatt Andrew, head of the NMC staff, who had recently been made assistant secretary of the treasury by President Taft. After a week of meetings, the six men had forged a plan for a central bank, which eventually became the Aldrich Bill. Vanderlip acted as secretary of the meeting, and contributed the final writing.

The only substantial disagreement was tactical, with Aldrich attempting to hold out for a straightforward central bank on the European model, while Warburg and the other bankers insisted that the reality of central control be cloaked in the politically palatable camouflage of "decentralization." It is amusing that the bankers were the more politically astute, while the politician Aldrich wanted to waive political considerations. Warburg and the bankers won out, and the final draft was basically the Warburg plan with a decentralized patina taken from Morawetz.

The financial power elite now had themselves a bill. The significance of the composition of the small meeting must be stressed: two Rockefeller men (Aldrich, Vanderlip), two Morgans (Davison and Norton), one Kuhn, Loeb person (Warburg), and one economist friendly to both camps (Andrew) (Rothbard 1984, pp. 99–101; Vanderlip 1935, pp. 210–19).

After working on some revisions of the Jekyll Island draft with Forgan and George Reynolds, Aldrich presented the Jekyll Island draft as the Aldrich Plan to the full NMC in January 1911. But here an unusual event occurred. Instead of quickly presenting this Aldrich Bill to the Congress, its drafters waited for a full year, until January 1912. Why the unprecedented year's delay?

The problem was that the Democrats swept the Congressional elections in 1910, and Aldrich, disheartened, decided not to run for re-election to the Senate the following year. The Democratic triumph meant that the reformers had to devote a year of intensive agitation to convert the Democrats, and to intensify propaganda to the rest of banking, business, and the public. In short, the reformers needed to regroup and accelerate their agitation.

THE FINAL PHASE: COPING WITH THE DEMOCRATIC ASCENDANCY

The final phase of the drive for a central bank began in January 1911. At the previous January's meeting of the National Board of Trade, Paul Warburg had put through a resolution setting aside January 18, 1911, as a "monetary day" devoted to a "Business Men's Monetary Conference." This conference, run by the National Board of Trade, and featuring delegates from metropolitan mercantile organizations from all over the country, had C. Stuart Patterson as its chairman. The New York Chamber of Commerce, the Merchants' Association of New York, and the New York Produce Exchange, each of which had been pushing for banking reform for the past five years, introduced a joint resolution to the monetary conference supporting the Aldrich Plan, and proposing the establishment of a new "business-

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men's monetary reform league" to lead the public struggle for a central bank. After a speech in favor of the plan by A. Piatt Andrew, the entire conference adopted the resolution. In response, C. Stuart Patterson appointed none other than Paul M. Warburg to head a committee of seven to establish the reform league. The committee of seven shrewdly decided, following the lead of the old Indianapolis convention, to establish the National Citizens' League for the Creation of a Sound Banking System at Chicago rather than in New York, where the control really resided. The idea was to acquire the bogus patina of a "grassroots" heartland operation and to convince the public that the league was free of dreaded Wall Street control. As a result, the official heads of the League were Chicago businessmen John V. Farwell and Harry A. Wheeler, president of the U.S. Chamber of Commerce. The director was University of Chicago monetary economist J. Laurence Laughlin, assisted by his former student, Professor H. Parker Willis.

In keeping with its midwestern aura, most of the directors of the Citizens' League were Chicago non-banker industrialists: men such as B.E. Sunny of the Chicago Telephone Company, Cyrus McCormick of International Harvester (both companies in the Morgan ambit), John G. Shedd of Marshall Field and Company, Frederic A. Delano of the Wabash Railroad Company (Rockefeller-controlled), and Julius Rosenwald of Sears, Roebuck. Over a decade later, however, H. Parker Willis frankly conceded that the Citizens' League had been a propaganda organ of the nation's bankers.[25]

The Citizens' League swung into high gear during the spring and summer of 1911, issuing a periodical *Banking and Reform* designed to reach newspaper editors, and subsidizing pamphlets by such pro-reform experts as John Perrin, head of the American National Bank of Indianapolis, and George E. Roberts of the National City Bank of New York. Consultant on the newspaper campaign was H.H. Kohlsaat, former executive committee member of the Indianapolis Monetary Convention. Laughlin himself worked on a book on the Aldrich Plan, to be similar to his own Report of 1898 for the Indianapolis Convention.

Meanwhile, a parallel campaign was launched to bring the nation's bankers into camp. The first step was to convert the banking elite. For that purpose, the Aldrich inner circle organized a closed-door conference of twenty-three top bankers in Atlantic City in early February, which included several members of the currency commission of the American Bankers Association, along with bank presidents from nine leading cities of the country. After making a few minor revisions, the conference warmly endorsed the Aldrich Plan.

After this meeting, Chicago banker James B. Forgan, president of the Rockefeller-dominated First National Bank of Chicago, emerged as the most effective banker spokesman for the central bank movement. Not only was his presentation

[25]Willis's (1923, pp. 149–50) account, however, conveniently overlooks the dominating operational role that both he and his mentor Laughlin played in the Citizens' League. See also West (1977, p. 82).

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of the Aldrich Plan before the executive council of the ABA in May considered particularly impressive, it was especially effective coming from someone who had been a leading critic (if on relatively minor grounds) of the plan. As a result, the top bankers managed to get the ABA to violate its own bylaws and make Forgan chairman of its executive council.

At the Atlantic City conference, James Forgan had succinctly explained the purpose of the Aldrich Plan and of the conference itself. As Kolko sums up:

> the real purpose of the conference was to discuss winning the banking community over to government control directly by the bankers for their own ends.... It was generally appreciated that the [Aldrich Plan] would increase the power of the big national banks to compete with the rapidly growing state banks, help bring the state banks under control, and strengthen the position of the national banks in foreign banking activities. (Kolko 1983, p. 186)

By November 1911, it was easy pickings to have the full American Bankers Association endorse the Aldrich Plan. The nation's banking community was now solidly lined up behind the drive for a central bank.

However, 1912 and 1913 were years of some confusion and backing and filling, as the Republican party split between its insurgents and regulars, and the Democrats won increasing control over the federal government, culminating in Woodrow Wilson's gaining the presidency in the November 1912 elections. The Aldrich Plan, introduced into the Senate by Theodore Burton in January 1912, died a quick death, but the reformers saw that what they had to do was to drop the fiercely Republican partisan name of Aldrich from the bill, and with a few minor adjustments, rebaptize it as a Democratic measure. Fortunately for the reformers, this process of transformation was eased greatly in early 1912, when H. Parker Willis was appointed administrative assistant to Carter Glass, the Democrat from Virginia who now headed the House Banking and Currency Committee. In an accident of history, Willis had taught economics to the two sons of Carter Glass at Washington and Lee University, and they recommended him to their father when the Democrats assumed control of the House.

The minutiae of the splits and maneuvers in the banking reform camp during 1912 and 1913, which have long fascinated historians, are fundamentally trivial to the basic story. They largely revolved around the successful efforts by Laughlin, Willis, and the Democrats to jettison the name Aldrich. Moreover, while the bankers had preferred the Federal Reserve Board to be appointed by the bankers themselves, it was clear to most of the reformers that this was politically unpalatable. They realized that the same result of a government-coordinated cartel could be achieved by having the president and Congress appoint the Board, balanced by the bankers electing most of the officials of the regional Federal Reserve Banks and electing an advisory council to the Fed. However, much would depend on whom the president would appoint to the board. The reformers did not have to wait long. Control was promptly handed to Morgan men, led by Benjamin Strong of Bankers Trust as all-powerful head of the Federal Reserve Bank of New York. The reformers had

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gotten the point by the end of congressional wrangling over the Glass bill, and by the time the Federal Reserve Act was passed in December 1913, the bill enjoyed overwhelming support from the banking community. As A. Barton Hepburn of the Chase National Bank persuasively told the American Bankers Association at the annual meeting of August 1913: "The measure recognizes and adopts the principles of a central bank. Indeed . . . it will make all incorporated banks together joint owners of a central dominating power" (Kolko 1983, p. 235). In fact, there was very little substantive difference between the Aldrich and Glass bills: the goal of the bank reformers had been triumphantly achieved.[26]

CONCLUSION

The financial elites of this country, notably the Morgan, Rockefeller, and Kuhn, Loeb interests, were responsible for putting through the Federal Reserve System, as a governmentally created and sanctioned cartel device to enable the nation's banks to inflate the money supply in a coordinated fashion, without suffering quick retribution from depositors or noteholders demanding cash. Recent researchers, however, have also highlighted the vital supporting role of the growing number of technocratic experts and academics, who were happy to lend the patina of their allegedly scientific expertise to the elite's drive for a central bank. To achieve a regime of big government and government control, power elites cannot achieve their goal of privilege through statism without the vital legitimizing support of the supposedly disinterested experts and the professoriat. To achieve the Leviathan State, interests seeking special privilege, and intellectuals offering scholarship and ideology, must work hand in hand.

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[26]On the essential identity of the two plans, see Friedman and Schwartz (1963, p. 17), Kolko (1983, p. 235), and Warburg (1930, chaps. 8 and 9). On the minutiae of the various drafts and bills and the reactions to them, see West (1977, pp. 79–135), Kolko (1983, pp. 186–89, 217–47), and Livingston (1986, pp. 217–26).

On the capture of banking control in the new Federal Reserve System by the Morgans and their allies, and on the Morganesque policies of the Fed during the 1920s, see Rothbard (1984, pp. 103–36).

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CREDIT CREATION OR FINANCIAL INTERMEDIATION?: FRACTIONAL-RESERVE BANKING IN A GROWING ECONOMY

JOHN P. COCHRAN, STEVEN T. CALL, AND FRED R. GLAHE

Austrian business cycle theory is in many important ways a capital-based macroeconomics (Garrison 1997). But many of the disagreements between supporters of the Mises–Hayek model of macroeconomic maladjustment and monetary disequilibrium or monetarist economists depend on differing interpretations of the essential nature of the money creation process in a fractional-reserve banking system with or without a central bank. Austrians view money creation in a fractional-reserve banking system as a credit creation process.[1] The market process which translates changes in money (and credit) into changes in prices and quantities is driven by injection effects.[2] Monetary disequilibrium theorists, Keynesians, and most monetarists view fractional-reserve banking as a form of financial intermediation. Real-balance effects, not injection effects, drive the economy's response to a monetary disturbance. This difference of opinion has even "fellow travelers" ardently rejecting Austrian business cycle theory.

Professor Leland B. Yeager is such a fellow traveler to whom Austrian economists owe a great debt for his contributions to monetary theory. Yeager (1997d, 1997e) has consistently stressed the importance of money as a medium of exchange and the importance of banks in the money-supply process. Injection effects and relative price changes are part of the economy's responses to monetary disturbances (Yeager 1997e, pp. 253–79). Many of the major errors and fallacies in

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[1]See Cochran and Call (1998), de Soto (1998), and Hoppe, Hülsmann, and Block (1998).

[2]See Garrison (1997, p. 23), "The Austrian theory of the business cycle emerges directly from a simple comparison of a savings-induced expansion, which is sustainable, with a credit-induced expansion, which is not."

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monetary thought can be attributed to theorists confusing the demand for credit with the demand for money (Yeager and Greenfield 1997, pp. 179–95). As a supporter of some elements of Austrian economics, Yeager (1997b, p. 164) feels, "The neoclassical and Austrian schools, each stripped of excrescences, are complimentary." Yeager (p. 155) also finds much to disagree with in Austrian economics, including "the specifics of their business-cycle theory."[3]

While much of Professor Yeager's work in monetary disequilibrium theory is compatible with Austrian economic thought, his view of injection effects and intermediation is remarkably similar to the views of John Maynard Keynes.[4] Yeager (ibid., p. 162) argues that fractional-reserve banking provides an important intermediary service, "Demands for additional 'money' thereby get intermediated into additional supplies of 'credit.' And this intermediation is appropriate. It does not counterfeit or misrepresent the availability of resources." If banks do not engage in such intermediation an increased demand for money may "impair the allocation of resources as savers and investors (and consumers) desire" (ibid.).[5]

Section two briefly reviews the Austrian model of credit creation, injection effects, and cyclical phenomena. Section three will analyze the key elements of the more traditional neoclassical synthesis model, which treats deposit banking as financial intermediation. Section four will look at Yeager's criticisms of Austrian business cycle theory in terms of these differing views of money, banking, and intermediation with particular emphasis on the role of fractional-reserve banking in a growing economy. Friedman's "plucking" model will be used to compare and contrast the two competing views. Section five will provide summary and conclusions.

Credit Creation and Injection Effects

The Austrian model presented here is based on the work of Mises (1971), Rothbard (1994), Hoppe, Hülsmann, and Block (1998), and de Soto (1995 and 1998), and Cochran and Call (1998). Money is a present good. As argued by Cochran and Call 1998 (pp. 33–34),

> Money is the medium of exchange and is thus the present good *par excellence*. The implied household decision tree is: a. Present goods or future goods (save)? b. If present goods, specific consumption goods or money? Saving is the sacrifice of present goods (a claim on present goods is temporarily foregone) for a claim on future goods. Since the holding of cash balances, whether in the form of deposits or currency, does not require the sacrifice of present utility, changes in cash balances financed from

[3]See Yeager (1986, 1997c, and 1997e) for detailed criticisms of the Austrian business cycle theory. For another critique of Austrian business cycle theory see Friedman (1993, p. 172). Garrison (1996) provides a thoughtful response.

[4]Cochran and Call (1998) contrasts Keynes and the Austrians.

[5]Contrast with Keynes (1936, p. 322). "The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and keeping us permanently in a quasi-boom."

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> current income are not a part of saving, but represent part of the allocation of income to provide present utility.[6]

Thus the proper economic interpretation of a deposit is that of a warehouse receipt. A deposit is a claim instrument, not a credit instrument.[7] A bank deposit (redeemable at par on demand) is not a debt transaction. It is a bailment in its economic impact even if it is treated as a debt by the legal system (Rothbard 1978, pp. 148–49). The money creation process made possible by fractional-reserve banking is not financial intermediation. It does not facilitate the transfer of savings to investors. Instead fractional-reserve banking and the associated money-creation process is a credit-creation process.

How money enters the economic system does affect the dynamic adjustment process. Institutions are an important component of the monetary transmission mechanism.[8] In an economy with a developed banking system, monetary changes often initially show up as changes in the availability of credit. Money enters the system (is created) as banks make new loans (create credit). Monetary changes that originate through the banking system have initial dynamic effects on spending because they alter credit available relative to savings available. A monetary change will thus alter the money rate of interest relative to the natural or equilibrium rate and disrupt the balance between savings and investment. Changes in investment relative to saving alter the demand for goods and services relative to their supply and lead to price level or output changes or both.[9]

Monetary changes are the loose joint in the saving-investment process. The problem, as initially explained by Mises (1971, p. 261) is that banks play two distinct roles in the credit process. While banks do negotiate credit through the loan of other people's money, they also grant credit through the issue of fiduciary

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[6]See also Rothbard (1976), de Soto (1998), Hutt (1979, chap. 8), and particularly Hoppe et al. (1998 pp. 20–28). This Austrian insight probably originated with Mises's (1971, p. 268 statement, "The claim that he has acquired by his deposit is also a present good for him. The depositing of the money in no way means that he has renounced immediate disposal over the utility that it commands." Contrast with the neoclassical formulation of Hicks (1951, p. 18): "A preference for holding money instead of spending it on consumption goods presents no serious difficulty, for it is obviously the ordinary case of the preference for future satisfactions over present." Notice the failure of the neoclassicals to see the similarity of the inverse relationship between consumption (present goods) and the interest rate and the inverse relationship between money demand (supposedly a future good) and the interest rate as a potential problem in their reasoning.

[7]See Rothbard (1994) and de Soto (1995 and 1998). Hoppe et al. (1998, pp. 21–36) provide additional support for the fiduciary media as credit-creation argument. Those who view fractional-reserve banking as harmless (beneficial?) financial intermediation fail to clearly recognize two principles of praxeology; no object can be owned by more than one party at a time and there is a "fundamental difference between property and property titles."

[8]Boettke (1997) provides a discussion of the importance of institutions and historical detail in "good" economic analysis.

[9]This effect of monetary changes on the money rate of interest relative to the natural rate and the consequent effect on the decision to invest relative to the decision to save constitute the intertemporal co-ordination problem that is the key feature in a "Wicksellian" approach to the monetary transmission mechanism (Bellante and Garrison 1988, p. 216).

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media, i.e., notes and bank balances that are not covered by money.[10] The first role is clearly financial intermediation. But according to Mises, the second role, credit issued by money creation, is not financial intermediation.[11] It is not a conduit of savings into investment. The transaction is different in nature from a true credit transaction, in which the lender temporarily surrenders "money or goods, disposal over which is a source of satisfaction and renunciation of which is a source of dissatisfaction" (Mises 1971, p. 264). Credit issued in the money creation process involves no reduction of current satisfaction on the part of the depositor and hence may finance investment (or other spending financed by money creation) without any prior equal savings.

Since there has been no actual saving, fractional-reserve banking may expand the supply of credit beyond the limits set by prior saving. Demand measured by monetary expenditure will increase. The initial responses of the economy will be determined by the tastes and preferences of those borrowing the newly created purchasing power. If the newly created credit enters the market as loans to businesses, spending by ultimate investors will be in excess of savings.[12] Economic activity is misdirected in favor of early recipients of the newly created credit and at the expense of those whose expenditures increase later in the adjustment to the monetary shock.

This mechanism is the monetary foundation of the Austrian business cycle theory as developed by Mises and Hayek.[13] The extension of credit (credit issued from bank reserves acquired from deposit banking or from reserves newly created by the central bank) through the banking system eventually causes an economic crisis. The normal operations of the money and banking institutions supported by a central bank generate business cycles. The recession phase of the business cycle is the economic correction of previous monetary excesses and malinvestments. The Austrian model predicts that the distortions in the structure of production will also occur if credit is created in a growing economy.[14] Expanding the money supply in a growing economy to stabilize the price level still creates circulation credit. The

[10]Rothbard (1994), de Soto (1995 and 1998), Hoppe (1994), and Hoppe et al. (1998) provide more recent developments of this argument.

[11]Mises calls the first type of transaction commodity credit and the second circulation credit. According to Mises (1971, pp. 268-69) circulation credit "is not a credit transaction, because the essential element, the exchange of present goods for future goods, is absent." Loan banking and deposit banking are Rothbard's (1994) terms for commodity credit and circulation credit.

[12]Rothbard (1978, pp. 152–53) provides a brief discussion of the effects on the economy if the credit enters the system as loans to government or consumers. While such loans may not generate business cycles, they do definitely generate a redistribution of wealth and purchasing power. Creation of new bank reserves by a central bank magnifies the potential distortions. Garrison (1994) discusses how credit creation impacts not only the length but also the risk of investment.

[13]Yeager (1986) provides an excellent summary of the Austrian business cycle theory as do Rothbard (1970), Cochran and Glahe (1994 and 1999), Hayek (1935 and [1933] 1966), Steele (1993), and Mises (1971).

[14]See Rothbard (1972) and Anderson (1979). Both authors use the model to explain the cause of the downturn leading to the Great Depression. Hayek "was one of the few economists

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extension of circulation credit leads to malinvestments and sets the stage for the end of the boom and the eventual economic correction and recession.

BANKING AS FINANCIAL INTERMEDIATION

The modern mainstream (neoclassical synthesis) view of money demand, savings, and fractional-reserve banking was developed from the insights of Hicks (1951) and Keynes (1936). In this approach the distinction made between circulating credit and commodity credit is either ignored or treated as invalid. Both forms of bank activity are considered to be financial intermediation.[15]

Banks are financial intermediaries that issue liabilities some of which the public willingly uses as a medium of exchange. Money is treated as a future good, not a present good. Saving is defined as current income less household spending on consumption. Hence additions to cash balances financed from current income are viewed as a form of saving. Changes in the money supply or money demand affect aggregate demand through real balance effects (wealth effects) and portfolio adjustments.

Bank liabilities that serve as a medium of exchange are part of the financial intermediation process. The saver prefers liquidity to return and decides to invest in money. The depositor loans funds to the bank and receives a bank I.O.U., a bank deposit payable on demand.[16] The bank now has ownership of additional loanable funds. When these reserves are loaned out, funds have been transferred from a saver (the depositor) to an investor. But in this case new money has been created. Both the borrower and the ultimate lender believe they have readily available purchasing power in the form of money. As the borrowed money is spent, it returns to the banking system as additional deposits. The process continues as new deposits become new loanable funds and new loans in turn create new money.

In the static model, when banks, for legal or economic reasons, deem it necessary to maintain cash reserves to back such short-term liabilities, total lending will be less than total saving. A dollar held in a reserve balance is a dollar saved but

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who warned about the possibility of a major economic crisis before the great crash." Hayek showed how " lending which exceeded the rate of voluntary saving would lead to a misallocation of resources, particularly affecting the structure of capital" (Royal Swedish Academy of Sciences 1974). Timberlake (1999) attempts to refute this argument with monetary data and an alternative institutional analysis. However, if money creation is credit creation and not financial intermediation, his data, despite his contention, are consistent with the Austrian interpretation.

[15]A more detailed development of this mainstream framework can be found in Cochran and Call (1998, pp. 35–38) or (sadly) in any standard money and banking textbook. Hoppe *et al.* (1998, pp. 37–47) provide another in-depth critique of this framework. The institutional (banking) details that are so important in the interest rate dynamics in the Wicksell–Mises–Hayek framework are totally ignored in this general equilibrium framework. Garrison (1999) has correctly argued that Keynes had once borrowed this interest rate dynamic framework from Knut Wicksell, but later rejected it. The modern credit-lending view of the monetary transmission mechanism has at least returned some of the institutional detail to the analysis of monetary policy. See Romer and Romer (1990), Robinson (1993), and Morgan (1992).

[16]Hoppe et al. (1998) use a title-transfer theory of contracts to argue that such contracts should be viewed as fraudulent.

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not lent to an ultimate investor. The supply of credit will fall short of available saving. With correct expectations the market interest rate will be above the natural rate. The economy will be in a permanent semi-slump. Investment will be less than savings, and Say's Law (in Keynes's sense) is broken. The income-constrained process will then lower output to a level consistent with the new lower level of investment.[17]

Financial Intermediation in a Growing Economy

Yeager (1986, 1997b, and 1997c) in general is critical of the Austrian business cycle theory. The specific Austrian business cycle theory is not needed to explain "why demands for capital goods, particularly of higher orders, fluctuate more widely over the cycle than demands for consumer goods and for investment goods closer to final consumption" (Yeager 1986, p. 382). The interest rate and relative price changes caused by the injection effects are mere details in the adjustment process.[18] Better, simpler explanations exist. Monetary disequilibrium, not the injection effects and distortions in the structure of productions, is ultimately the cause of economic downturns. According to Yeager (ibid., p. 380), "Monetary disequilibrium theory, in contrast, can handle the phenomena of boom and depression with less specific suppositions; unlike the Austrian theory, it does not disregard Occam's razor."

Yeager is even more critical of the model applied to a growing economy. Monetary policy following Austrian recommendations would trigger, not prevent, the crisis. Yeager (1997e, p. 253), using the neoclassical synthesis interpretation of savings, money demand, and financial intermediation, criticizes Rothbard (1972) and Anderson (1979):

> Their view fails to recognize how the entire monetary system can function as a financial intermediary and how monetary expansion working to stabilize the price level in a growth context, far from emitting false signals about the availability of resources, can facilitate the transfer of resources released by savers into the control of entrepreneurs who will employ them for investment projects.

Recessions or downturns are caused by an excess demand for money combined with rational downward price rigidity. In a growing economy the expanded volume of production and transactions should lead to an increased demand for money. As economic agents in the aggregate attempt to build up cash balances, they refrain from buying, "they are relinquishing or postponing command over resources" (Yeager 1997e, p. 258). The money balances represent not present but

[17]Keynes (1936, pp. 178–85) and Cochran and Call (1998, pp. 35–38). Krugman (1998) provides an interpretation of a liquidity trap as a cause of recession that is compatible with this disintermediation view of economic stagnation. Krugman (pp. 155–56) cites studies by Bernanke (1994) and Cooper and Corbae (1997) as source of an argument that a "dramatic decline in the money multiplier was the signature of a major episode of financial disintermediation; and that this disintermediation . . . was the cause of the sustained slump."

[18]While Yeager (1997e, p. 253) does recognize the existence of injection effects, he downplays their importance.

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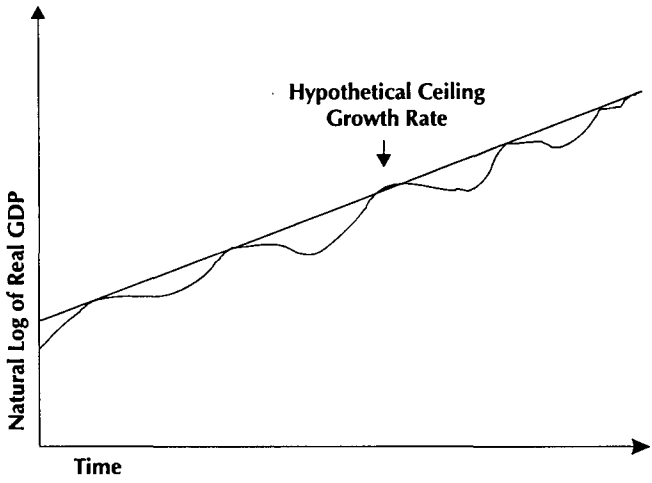
future goods. Saving has occurred. As in the static Keynesian scenario, saving exceeds investment and the economy faces contractionary forces. But

> If, now, the money and banking system expands the volume of banknotes and deposits through expanding the volume of its loans to business firms, it is acting as a kind of super financial intermediary. The public, in acquiring new money, is relinquishing command over resources; and the money and banking system, in expanding its loans, is transferring command over those relinquished resources to the borrowers.
>
> In the situation described, the monetary system is *not* counterfeiting the availability of resources released by saving; it is not falsifying interest-rate signals in the manner envisaged by Austrian business cycle theory. People building up their cash balances really are relinquishing current command over some of the resources to which their current revenues entitle them, and the money and banking institutions are accomplishing intermediation that transfers command over resources to borrowers who will employ it for their own purposes, including productive investment. (Yeager 1997e, pp. 258–59)

Figure 1
A Stylized "Plucking Model" of the Economy



The contrast between the two approaches can perhaps best be illustrated by using a stylized form of the Friedman (1993) plucking model (see Figure 1). The important feature from the model for this study is that "U.S. data on real output show an important 'ceiling' effect; growth rates are on average below the ceiling rate, but tend back to the ceiling rate" (Goodwin and Sweeney 1993, p. 178). Why does such a pattern in the data appear? Both a monetarist/monetary disequilibrium model and an Austrian model can be used to explain the observed business cycle phenomena.[19]

[19]The Austrian interpretation of the plucking model is based on Garrison (1996).

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In the monetarist model, "natural" full-employment growth is interrupted by monetary disequilibrium, the "money string is plucked downward" (Friedman 1993, p. 173). These plucks may be random policy errors which decrease the supply of money (à la Friedman) or may result from a failure of the banking system to "fully intermediate" an increased demand for money in a growing economy (à la Yeager). In either case, an excess demand for money coupled with price rigidity triggers a recession followed by a subsequent recovery that may or may not be aided by an expansionary policy.

In the Austrian model, the problem develops as an investment boom. Investment (and growth) generated by savings is sustainable, while investment (and growth) generated by credit creation is not, As Garrison made clear (1996, p. 800),

> The boom for the Austrians refers to something going on largely *within* the output aggregate. It is represented in Friedman's plucking model not by a conspicuous recovery to trend but rather by some period preceding a pluck which Friedman, operating at a higher level of aggregation, presumes to be healthy growth.

The credit-induced boom is, however, malinvestment, not healthy growth. While the downturn may appear to be the result of a pluck (a central bank or banking sector-induced restriction in credit availability), more careful analysis makes it clear that a "policy-induced boom contains the seeds of its own undoing" (Garrison 1996, p. 800).

CONCLUSIONS

Yeager, using the Keynes–Hicks framework, argues that the Austrians are wrong on all three monetary theory-institution issues. Money is a future good, not a present good. Accordingly attempts to increase cash balances from current income flows represent savings. A demand deposit or bank note is a debt instrument in both its legal and economic aspects. Money creation through fractional-reserve banking is financial intermediation. Such financial intermediation facilitates the flow of resources from savers to investors. Growth in the money supply may be needed to prevent or postpone a recession, particularly in a growing economy.

However, the neoclassical synthesis approach misinterprets the important economic and institutional features of the money demand, savings, and credit creation process. Credit creation is not intermediation. It can and does lead to malinvestment. Money and credit creation is a self-reversing process with the potential to generate cycles that could be prevented by avoiding credit creation.

In addition, critics are excessively concerned with how an economy would respond to an excess demand for money caused by an increase in the public's demand for real cash balances. Historically, when an excess demand for money has created economic adjustment problems, it is much more likely to have been caused by a decline in the money supply that ultimately resulted from initial

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over-expansion of the money supply.[20] Such excess demand situations could be prevented by 100-percent reserves in a commodity (market based) monetary system or greatly reduced in a free banking system with convertibility to a market-chosen, commodity base-money and strict enforcement of bankruptcy.

If an excess demand for cash balances did develop due to a change in demand preferences of economic agents, it should be recognized that this is not a change in time preferences. As pointed out by de Soto (1998, p. 36), "The decision as to the proportion that will be spent on consumption or investment is different to and independent of the decision on the fiduciary media and cash balances one wishes to hold." No new saving has occurred. Individuals now place a higher value on cash as compared to other present goods. The correct adjustment is not a change in the rate of interest, but an adjustment in the relative price of money and other present goods. As Yeager (1997d) has pointed out, money has no market of its own. Individuals who have an increased demand for cash will curtail spending and increase sales offers, but the decreases in spending will be decreases on specific goods and the increased sales offers will be offers to sell specific goods. The market will solve the "who goes first problem." Prices will decline first in the individual markets affected by decreases in spending and increased sales offers.[21] This analysis implies that in a growing economy no increase in the demand for money need develop. Growth develops in specific industries, not as an aggregate phenomenon. As industries expand, prices for the products produced by the growing industries fall relative to both other goods and money.[22] An expanding level of transactions in goods is accompanied by declining prices.[23]

While it is important that Austrians continue in their endeavor to convince colleagues, policymakers, and the public about the instabilities inherent in a

[20]It is curious to observe how the modern theorists

> seem obsessed by short-term unilateral changes in the demand for money. However, such changes historically have been produced over an economic cycle—during the last stages of booms and crises—which almost always begins as the result of *previous* changes in the supply of new money created by the banking system. (de Soto 1998, p. 27, n. 9)

While the modern approach would view this as disintermediation, the Austrian model correctly argues that such "disintermediation" would not be possible without fractional-reserve banking and credit creation. Economists also must clearly distinguish between an increased demand for money and a change in the preference of the type of money demanded (currency or deposits in the modern system).

[21]Hutt (1979, pp. 191–92; 1974, pp. 61–65) also argues that markets should adjust to changes in money demand as they would to any other change in preferences. Failure of the market to coordinate economic activity is caused by "withholding of supply" in specific individual markets.

[22]The price trend in the personal computer industry is a good example of such a trend. In the 1992 to 1997 period prices in the industry fell between 5 percent and 20 percent per year. The long-run average (1968–96) was –11.8 percent. See Duca (1997).

[23]Selgin (1997, pp. 64–67) makes a similar argument relative to economic growth and price changes and recommends a productivity norm as a guide for monetary policy. He follows Yeager and other monetary disequilibrium theorists in their concern that an increased demand for money can be a major source of monetary and macroeconomic instability.

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fractional-reserve system, Austrians need to remember that economic fluctuations can have other causes. Other approaches may be complementary to the Austrian approach. Monetary disequilibrium can be the source of a contraction and may be essential in modeling the adjustment process in the recession period (the Hayekian secondary deflation). Real business cycle theory should remind Austrians that real shocks do occur and markets do adjust.[24] Credit creation and malinvestment could complement real business cycle research, which has difficulty explaining satisfactorily why downturns occur. A technology shock accompanied by credit creation, however, has elements of healthy growth and unhealthy growth. Austrian business cycle theory can augment real business cycle theory by explaining both the boom and the necessary correction.

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[24]Hayek (1966, chap. 2) addresses this issue in *Monetary Theory and the Trade Cycle*.

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THE NOBLEST TRIUMPH: PROPERTY AND PROSPERITY THROUGH THE AGES. BY TOM BETHELL. NEW YORK: ST. MARTIN'S PRESS, 1998

According to the nursery rhyme, "There once was a little girl with a curl, when she was good, she was very, very good; when she was bad, she was horrid." Much the same can be said about this book.

What are the very, very good parts? It is a thorough, lively, and almost encyclopedic defense of private-property rights. In this benighted age, there are not too many of those around. Ranging far and wide, Bethell shows the benefits of private property throughout history and in virtually every corner of the globe. He demonstrates how the institutions of private property can solve environmental problems, were responsible for the success of the industrial revolution in England, how the lack of them accounted for the failures of the U.S.S.R., feudalism, and the third world. His explanation of the Irish famine is alone worth far more than the price of admission. Standing head and shoulders over many purely economic defenses of this institution, Bethell's book also demonstrates the virtues of property rights on political and moral grounds.

The horrid part of the book is that its case in favor of private-property rights makes needless compromises; it is hemmed in by a welter of caveats, restrictions, exceptions, and provisos. In light of these, a better title for it might have been "Two Cheers for Private-Property Rights," or "A Semi-Noble Triumph: Limited Property Rights and Prosperity Through the Ages."

BACKGROUND

Private-property rights (including self-ownership rights) may be articulated on three basic levels: logic; justice, and economic efficiency.

The first point is that it is self-contradictory to try to *deny* the concept of private-property rights. For the denier must use, at least, his vocal chords, chest cavity, etc., and have a place to stand (Hoppe 1993). If there are to be no private-property rights, whence came the critic into legitimate possession of the wherewithal necessary to make his very objection?

Second, justice. Without such rights, there can be no justice (Rothbard 1982). For justice, at least in the realm of law, consists of no more and no less than ensuring that owners of personal and physical property are allowed full use of them; injustice, in contrast, is limited to a denial of such a state of affairs.

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There is no injustice that cannot be reduced to a violation of private-property rights.[1]

Third, economic efficiency. Even Chicagoans such as Bethell can be trusted on this one, for the most part. Our author, for example, weighs in heavily with his attacks on central planning (p. 142), foreign aid (pp. 208–15), welfare (p. 164), "social justice" (pp. 162–68), uncompensated "takings" (p. 181), land use regulations (p. 182), and support of the industrial revolution (pp. 87–91) and privatizing universities (p. 180). He knows, and tells us in loving detail, that those countries which have relied upon private property to a greater degree than others have also been more prosperous (pp. 12, 28, 337–38).

Bethell, moveover, correctly identifies the various aspects of private property as "the rights to use the thing and to exclude others from doing so, to alter its physical configuration, to enjoy its fruits, including its income, and, not least, to transfer the title of ownership to another" (p. 19). This means, or at least it should mean, that the owner should be allowed by law to do *whatever* he wishes with his legitimately held property, provided *only* that he does not thereby violate the equally valid private-property rights of others.

ANARCHISM

There are several key implications of a fearless and thorough-going analysis of private-property rights, however, on which Bethell fears to tread. One of them is anarchism.[2] Why anarchism? Why is the existence of a compulsory government the enemy of private-property rights? States do two things which take them out of the realm of free markets based upon private-property rights. First, they *compel* allegiance to themselves.[3] They *demand* that all people within a given geographical area subscribe to their system of laws, and pay taxes for this privilege. But Bethell said that private property confers "the rights to use the thing and to exclude others from doing so." If so, then the individual surely has the right to *exclude the government* from the use of his property, without permission.[4] Second, a state demands a *monopoly* of power within its geographical area. That is, it will use force to crush any private agency daring to set itself up in competition with it, offering police, judicial, etc., services.[5]

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[1]Again, I am limiting this to the legal realm. If I make a promise to you, but then break it, this might well be "unjust." But since this does not involve an uninvited border crossing, or the initiation of violence, it is not taken cognizance of by the libertarian legal system as "unjust."

[2]I would not bring up this issue in a review of a book ostensibly on private-property rights if not for his gratuitous attack on statelessness (p. 339).

[3]All throughout his book, Bethell waxes indignant about the use of force and compulsion as the enemy of freedom, liberty, and private-property rights (see, for example, pp. 76, 84, 137, 192). Why does this well justified antipathy not apply to the government?

[4]If, of course, the person *agrees* to deal with a protection agency, and pay it fees for protection, judiciary and other such services, then this is a private defense firm, not a government at all. See on this Hoppe (1993), Rothbard (1982), Friedman (1989), and Spooner (1966).

[5]In the view of Bethell (p. 25) "some goods are naturally managed by the states—those that

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And what is Bethell's take on all of this? He (p. 339) asserts:

> In most places and times [it] is obviously not true [that] . . . anarchy begets efficiency. There has been plenty of unproductive anarchy in the world. One only has to think, recently, of Haiti, Sudan, and Somalia. Nothing good has come of the institutional near vacuum in these countries.[6]

This is a bit of a departure for those who oppose the fully free society. For it concedes that at *some* times and *some* places society managed to function without the state.[7] But if we define anarchy as places without governments, and we define governments as the agencies with a legal right to impose violence on their subjects, then whatever else occurred in Haiti, Sudan, and Somalia, it wasn't anarchy. For there were well-organized gangs (e.g., governments) in each of these places, demanding tribute, and fighting others who made similar impositions. Absence of government means absence of government, whether well established ones, or fly-by-nights.[8]

EMERGENCIES

Nor is this merely a dispute over formal anarchism. Bethell makes excuses for governmental activity all throughout his book; preeminently, he makes exceptions to the rights of private property for "emergencies." For example, he states (p. 322): "The common law has long held that people may be entitled to trespass on others' rights in emergencies. And no doubt . . . [p]roperty rights should give ground when time is short."[9]

But one man's "emergency" is just another man's violation of private-property rights. Bethell is fully aware of just how subjective things can be when he (very perceptively) attacks Demsetz (1967) for overlooking subjectivism (p. 47), but when it comes to making exceptions for governments to violate private-property rights for this reason, he appears to lose sight of his own insight.

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are needed to provide for the common defense, for example, or for administering justice and enforcing the law. Such goods are natural monopolies."

[6]Elsewhere, Bethell (p. 12) equates anarchy with, of all things, "tyranny."

[7]Surely, the present situation of anarchy between the some two-hundred presently constituted nations of the world would have to be opposed by anti-anarchists such as Bethell. This logically implies that he favors a one-world government (with China and India, the most populous countries, together controlling global politics). If not, and I suspect not, then this author must rescind his opposition to anarchism.

[8]As Spooner (1966) shows, the only difference between a gang and a government is better public relations on the part of the latter.

[9]Bethell (p. 9) also sees "private property [as] a compromise between our desire for unrestricted liberty and the recognition that others have similar desires and rights." But this is a very perverse way to interpret liberty. Liberty, used in this context, is a synonym for license, for the right of the individual to do whatever he wants to do, even if it violates the equal liberties of others. Who, with this definition, could favor liberty? Who could be a libertarian? Surely, a more reasonable definition of liberty (utilized in this review) is the right to do with your own property whatever it is you wish, provided only that this doesn't interfere with anyone else's similar liberty. Nor is Bethell's dismissal of libertarianism only implicit. On the contrary, he (p. 25) goes so far as to characterize this philosophy, along with Marxism, of all things, as dogma.

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Nor can any reasonably well-informed man be unaware of the fact that there are always emergencies. Consider that spate of advertisements inviting charity abroad: "Here is little Maria. She will soon die of lack of food. You can send her $15 per month, or turn the page" (I paraphrase here). As I write this, the tragedy of Yugoslavian refugees, many of them children, are there for all the world to see on television.

Bethellnomics would appear to imply that all bets are off, private property wise, while there is an emergency anywhere in the world. For if emergencies justify governmental violation of property rights, and there are always emergencies somewhere in the world, even in each country, then statist depredations on our sacred rights of private and personal property are *always* justified. This is a *defense* of our noblest triumph?

But we don't have to reach far and wide for a refutation of this Bethellian decline into socialism. He stands condemned on the basis of his own words. For in his well-taken critique of zoning and urban renewal as an affront to private property, he objects to the use of "the legislature's 'police power'—its authority to act on behalf of the public safety, health and morals" (p. 297). But what more is this police power, that he objects to in the context of zoning and urban renewal, than the self-same governmental power to act in emergencies?

COMMUNALISM

Another problem with our author's vision of private property arises with regard to communalism. He states (p. 25): "Broadly speaking, there are three configurations of property rights: private, communal, and state." This is entirely erroneous. The truth of the matter is that there are but *two* divisions of property: just and unjust. Into the former category are placed *both* private individual and private communal.[10] Why? Because, as even Bethell acknowledges, legitimately held property is based on initial homesteading (Locke 1960, p. 86) and lawful title transfer.[11] If I homestead some land, or purchase it from the legitimate owner with money I have earned honestly, and then farm it by myself, Bethell will support me. But, if I turn around and share it with a bunch of communitarians, as did Robert Owen, I will get the back of the hand from Bethell. Our author goes so far as to link Owen with, of all people, the leaders of the U.S.S.R. He does this, implicitly, by considering the two in one section of his book. Section 5 is entitled "The New Man," with two chapters: "Robert Owen's Trinity of Evils," and "The Soviet Experiment." He does this explicitly with the following statement (p. 127): "In 1816, Owen opened his Institute for the Formation of Character, more or less anticipating Soviet developments 100 years later." More or less anticipating? The Soviets killed tens of millions of people, violating property rights on a truly gargantuan scale (Conquest 1986, 1990); as well, under forced collectivization, and the expropriation of practically

[10]Into the latter go *both* kinds of stolen property, individual, e.g., stolen by a single robber, and communal, stolen by gangs, whether "private" or governmental.

[11]In this context Bethell could well have cited Nozick (1974), but did not.

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all goods, houses, factories, and means of production, these brutes violated the rights of physical property to a tremendous extent. Owen, in contrast, not only murdered no one, he engaged in his communalist experiments with his own money; he was joined in them by willing collaborators. Even Bethell admits (p. 125) that Owen "spent his own money on the cause in which he so firmly believed."[12]

There is nothing intrinsically wrong with communalism. Yes, when combined with force, it is a particularly evil brew.[13] But take away the coercion, and it is rendered powerless, even, sometimes, beneficial. It is the same with practically anything. For example, there is nothing wrong with pizza. But if everyone were forced to eat this foodstuff, every meal, every day, numerous deaths would no doubt ensue, perhaps, even, who knows, equivalent to the loss of life which resulted from forced communism. Does this mean we should oppose pizza (communism)? Not a bit; only when it is imposed through force.

Owen's New Lanark and New Harmony communes didn't work in the sense that they only lasted for a few years. But no less is true of thousands of business firms which go bankrupt after a similar period of time. Would Bethell wish to condemn the latter in the manner he does the former? Soviets indeed!

Bethell can perhaps be interpreted as being on firmer ground in his discussion of the evils of communalism with regard to the Plymouth experience. After all, at least some people died—not in Soviet proportions, but there were a few. But even here, Bethell's conflation of coercion and communalism does him in. For what was wrong with Pilgrim economics was *not* that "it sets up a system of rewards and punishments that puts the welfare of the community on a collision course with human nature" (p. 31). Rather, the problem was that this system of communism was done on a *coercive* basis.[14] Had this not been the case, had the Pilgrims been perfectly free to arrange economic matters on an individual basis, then, one of two things would have happened. Either they would have come to their senses and substituted private individual property for private communal property, given that the former was not successful. Or, and this is a very big *or* indeed, they would have stuck to their guns, gone down starving as they did, and we would have been forced to interpret this situation as one in which they all preferred death rather than the dishonor of not living communally. How else could such a situation possibly be analyzed, again, on the assumption that all involved were consenting adults?

But is communism of the voluntary variety always unsuccessful? Not at all, as even Bethell himself admits. For example, he acknowledges that this is indeed the system which most families utilize. As well, religious orders and organizations such

[12]Bethell (p. 132) further states: "Owen . . . proposed that the Harmonites should form themselves into a Community of Equality right away, with the property—*his property*! to be shared in common" (emphasis added).

[13]Bethell recognizes the evils of initiatory force in the context of foreign aid and planning, but not when it comes to voluntary communal property (p. 192).

[14]Bethell (p. 35) describes the economic system as the "*Crown*-devised policy of joint possession" (emphasis added).

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as monasteries, nunneries, Hutterites, Jesuits, etc., live by the maxim, "from each according to his ability, to each according to his need." Yet, such is our author's visceral and Chicagoesque antipathy toward allowing people to be free to choose their own paths in life, that he still cannot give up his opposition to capitalist acts between consenting adults of a socialistic variety. This sounds like a contradiction in terms, but only because Bethell cannot discern which system is the real enemy of the free society.

Consider, then, the following chart:

Figure 1

	Socialism	Capitalism
Coercive	A	B
Voluntary	C	D

Here, A stands for coercive socialism of the Soviet variety, and C depicts voluntary socialism of the kibbutz, commune, family, religious order, or Owen's New Harmony. D represents laissez-faire capitalism, where all economic action is based on legitimate private-property rights and voluntary contract, while B features the veneer of capitalism and private firms, but these are hedged in with a welter of government interferences with the market. Examples are Hitler's Germany, Italian fascism, and, of course, the present economic system of the United States.

Most commentators, Bethell specifically included, think that the crucial debate in political economy is between socialism and capitalism. This, in our terms, would place A and C on one side of the barricades, and B and D on the other. Nothing, however, could be further from the truth. In fact, the real contending parties are A and B versus C and D. It is not socialism versus capitalism, but, rather, a purely voluntary system which allows full sway to the choices of the owners of private property (whether they wish to use their holdings individually or communally it matters not one whit) *vis-à-vis* a coercive system where some people dictate how others can use their property rights. And again, it matters little whether there is a superficial coating of capitalism or socialism to which lip service is given.

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Bethell misconstrues the enemy of freedom. He thinks it includes C, which is why he takes off after poor inoffensive Owen.[15] Our author offers a half dozen *ad hoc* defenses of his thesis, concerning the size of the commune, its religiosity, familial relations, etc. All of this is totally beside the point. In other words, were communalism *per se* a violation of property rights, then these things wouldn't matter at all. That these considerations actually do matter, are even crucial, only underscores the point that the commune is fully compatible with property rights.

Consider Bethell's analysis of sharing restaurant checks (p. 44):

> When property is communally owned, there is no "mine" or "thine" by intention. Everything is "ours." This is likely to create dissension, as it did at Plymouth Colony. The lack of ratio between effort and reward "was thought injustice." Such an outcome may be expected when members have rights to equal shares in the product of a community. Those who contribute little will enjoy a free ride at the expense of those who work hard. We recognize the free-rider problem, even if we don't know its name. A group dividing the check equally at a restaurant will encounter it. Those ordering expensive items will come out ahead. Separate checks are the solution—the equivalent of privatization.

But suppose a group of friends at a restaurant reject Bethell's advice. Are they guilty of a private-property rights violation? Not even this author, presumably, would go that far. For these people have every right to share the check precisely as they wish. This is hardly the opposite of privatization; rather, it is the *embodiment* of the free society, in microcosm. Each of the diners decides this for himself; they all agree to allow "free riders" on a unanimous basis.

With this analysis Bethell has ceased being a commentator on political economy; he has taken on the role of the managerial consultant. He is *advising* people not to split restaurant checks, not to join communes, etc. But what business is it of his *how* people enjoy their private-property rights? As a presumed advocate of this system, he is supposed to be neutral on such issues. That he is far from neutral about them only lessens his claim to be a defender of our "Noblest Triumph."

MARKET FAILURE

But this is not the end of the mischief caused by his mistaken analysis. Because of it, Bethell is also led into the trap of accepting the doctrine of "market failure," at least when it comes to so called "free riders,"[16] "nonexcludability," "tragedy of the commons," and "public goods."[17]

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[15]Inoffensive, that is, in what he *did*, not necessarily what he *advocated*.

[16]It is no exaggeration to say that complaints about free riders form the core of Bethell's defense of private-property rights. He mentions them often: (pp. 31–32, 42, 44, 46, 49, 51, 54, 137, 157, 167, 268, 323).

[17]Market-failure doctrine leads a long and not very savory life in the history of economic thought. In addition to the three mentioned in the text other major accusations against the free market include monopoly, inequitable distribution of income, slow growth, unequal information. For critiques of this doctrine see Hoppe (1993), Hummel (1990), and Rothbard (1962).

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The free-rider problem comes about, as alleged by most mainstream economists when all the benefits of an act cannot be confined to those who undertake their costs. Free riders, beneficiaries who do not pay their own way, cannot be excluded from the enjoyment thereof. Therefore, either the act will not be carried out at all, or there will be underinvestment in it, at least compared to the situation where this problem does not arise. And what does our free enterpriser Bethell add to this? He (p. 50) asserts that this problem "may be insoluble, in which case government action may be called for." Surely this deserves to rank amongst the all time malapropisms. If the free-riding problem is truly insoluble, how on earth are government bureaucrats going to solve it? Do they have magical powers?

The government solution, of course, is to *force* the recalcitrant non-paying beneficiaries to cough up their "fair" share of the costs through taxation. But this opens up a Pandora's box of difficulties. For one thing, how do we *know* that the free rider really benefits?

The most typical illustrative example is national defense. It is argued that we all benefit from the army, navy, marines, etc., in that they protect us against invasions from foreigners.[18] Says Bethell (p. 51):

> Because a national defense system will protect those who don't pay for it, a privately financed defense system will immediately run into the free rider problem. As a matter of both justice and practical politics, therefore, the government intervenes and taxes are levied from all to pay for such goods.

But what of the pacifist? Can Bethell and the other advocates of this view seriously maintain that pacifists such as the Amish benefit from expenditures on military hardware, that is, in their own view?[19] According to the old adage, "One man's meat is another man's poison." Bethell, again, superbly wielded this subjectivist concept in his critique of Demsetz (1967, p. 47), only four pages earlier.

Further, if the government levies coercive taxes[20] on those unwilling to pay for defense, it will be doing for these hapless individuals exactly the opposite of what it is purporting to do for them. That is, the whole point of the exercise is presumably to *protect* the citizenry. This can hardly be done when, at the outset, the state initiates the very violence against them from which it is supposed, according to the theory, to be *saving* them.

Nor is it entirely outside the realm of the possible to exclude at least some of those who refuse to pay for service. All the government (or the private defense agency) need do is issue placards to its clients. Those without them, whether on their persons or their property, will be fair game for criminals, whether domestic or

[18]As of this writing, the U.S. military is busily trying to bomb the Serbs back into the Stone Age, people who never even remotely threatened to invade us, let alone took even the slightest of baby steps in that direction.

[19]See on this Rothbard, 1962, pp. 883–90.

[20]And what other kind of taxation is there?

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foreign. They would have to make their own private arrangement for protection, on the assumption they were not pacifists.

It is possible, too, to apply a *reductio ad absurdum* to this entire line of argument. If Bethell can assert, in the face of pacifists,[21] that *everyone* benefits from national defense, then I can claim, with equal justification, that we all gain from the things *I* enjoy, such as handball, chess, karate, libertarianism, Austrian economics, and baroque music. All people, whether they know it or not, benefit from these avocations, not only directly, themselves, but even when others engage in them. This is because their practice makes people "better persons," and this, in turn, "spills over," even to those "refusenicks" who do not directly participate. Therefore, I confidently assert, there is less than an optimal amount of investment in these things[22]; government must subsidize all those involved in these pursuits. The point is, by use of this "logic," anyone can prove anything he wants.

Particularly disappointing[23] is Bethell's defense of highway socialism[24]: e.g., his support for governmental, as opposed to privatized[25] vehicular thoroughfares. In his view (p. 51):

> Road building has with reason been a government activity for a long time, mainly because the cost of collecting fees from road users has been high. The private purchase of right of way also runs into the problem that holdouts can command monopoly prices. But digital technology is reducing the cost of collecting tolls, and if, in the years ahead, clogged freeways are not cleared by user fees [collected by road scanners "reading" prepaid magnetic strips and deducting a toll] then ideology will surely have trumped technology.

This simply will not do. Private roads, too, have been around for a long time. Some of the first highways in the United States were built by private turnpike companies. The reason for their failure had little or nothing to do with the costs of collection being high. Rather, it was due to the fact that governments, the self-styled protectors of private property, refused to safeguard the toll houses of these corporations from physical attack.[26] Digital technology, universal product codes, have been in operation in grocery stores, pharmacies, supermarkets, and railroads,

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[21] As well as traitors.

[22] Soap, too, by the way.

[23] See on this Block (1979, 1980, 1983a, 1983b, 1996b); Block and Block (1996); Cadin and Block (1997); Gunderson (1989); Klein (1990); Klein, Majewski and Baer (1993a, 1993b); Klein and Fielding (1992, 1993a, 1993b); Roth (1966, 1967, 1987); Rothbard (1973), Woolridge (1970).

[24] One hopes the context here, as well as in the case of "water socialism," below, will make clear that we are referring to coercive and not voluntary socialism.

[25] Another self-contradiction. When it comes to Robert Owen, or "the tragedy of the commons," or, friends splitting restaurant checks, Bethell is adamantly in favor of privatization. Why not, then, real privatization in the case of streets and highways?

[26] Demsetz (1967) would likely claim that it was too *expensive* for the government to do so. This presumes that the state can discern just which enterprises it is appropriate to shield, and which not. But this is unconvincing. A police presence, in any case, was not required at every toll

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etc., for some three decades now; only very recently has the government bestirred itself sufficiently to utilize these breakthroughs on the nation's highways. And when it does, for Bethell this is only a reason for allowing *government* managed highways to reduce traffic congestion, not for full privatization.

Worst of all, under statist management, some forty-thousand people per year lose their lives due to traffic accidents. Instead of accepting responsibility for this carnage, apologists for highway socialism are apt to blame it on speed, drunken driving, poor weather conditions, and a whole host of other reasons, none of them having to do with government management. But it is the failure of the statist highway managers to *deal* with these phenomena which is ultimately responsible for the massive fatalities.[27] We must realize that the same folks who bring us such great efficiency in the Post Office are also responsible for managing roads and streets. In any case, why a defense of government highways in a book devoted to private property?

And what of "rights of way" and "holdouts"? Bethell is off base on these considerations, too. In the United States there is a long history of private ownership of railroads. These, like roads, are very long, thin enterprises. If rights of way were not a sufficient reason for governmental trains, they are not, either, for highways. As to holdouts, these are precisely the people a book devoted to the noblest triumph ought to be *defending*, not denigrating. For holdouts are private-property owners, going about their business, refusing to sell to developers. In any case, there are many ways to deal with holdouts. One can build a road around, under or over them (Block and Block 1998). Ironically, Bethell himself touches upon yet another commercial technique in this regard: options. Only two pages after the above quote (p. 53) he mentions these, but only in the context of land assembly for Disney World in Florida. He doesn't seem aware of the fact that the private street builder, too, can avail himself of this course of action.[28]

LAW AND ECONOMICS

Coase is the litmus test for anyone who wants to be considered a defender of private-property rights. Bethell passes this test, although not with flying colors; rather, just barely. But he does pass, and this is an exceedingly rigorous test, at least for those with strong Chicagoesque tendencies, such as our author.

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gate, any more than a cop is needed at each store. It would have sufficed had government merely threatened to punish toll booth violators, should they be apprehended, the same sort of offer presumably made to every other property owner.

[27]In like manner, we do not blame the bullet, but the gunman, for the murder. Similarly, the restaurant *manager* is the ultimate cause of business failure, not the proximate causes of poor service, bad food, dirty floors, etc. It is the manager's job to improve these conditions.

[28]Consider the strategy of the highway owner who wants to build between points A and B. All he need do is to buy option to purchase land along five or six alternative routes. Only when he has a complete set of options for any one of them—with no holdouts—does he exercise his option and actually purchase the land.

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What are the specifics? Coase, in 1960, took the economics profession by storm with his article "The Problem of Social Cost." It became the most heavily cited article of all time[29] and launched the *Journal of Law and Economics*, which, in turn, became a mainstay of the new subdiscipline, law and economics. The essence of Coase's message had to do with real-world positive transactions costs. Here, property under dispute (and this would mean *all* property, once Coasianism became the law of the land) should be given *not* to its rightful owner (indeed, the idea of rightful ownership, justice, etc., has no place in the Chicagoesque philosophy), who had either homesteaded it or purchased it from a person who had mixed his labor with the land (Locke 1960; Rothbard 1982; Hoppe 1993; Nozick 1974). Rather, the property should be given to that party who, in the judges' opinion, would make best use of it in the future and in that way maximize total wealth.

Suppose I were to "steal" your wallet (it is now necessary to affix quotation marks to this word, since its meaning changes violently in the Coasian world). The old-fashioned (pre-Coase) judge would enquire into the *past history* of this item. Were your credit cards and pictures of you and your family in it, and did this wallet have a bill of sale with your name on it, that would pretty much be the end of the matter. I would be the thief, you the rightful owner. However, for the judge under the baleful influence of Coase, the past would be *irrelevant*. Sunken costs, after all, hold no sway for the economist. On the contrary, the judicial enquiry would turn on the *future*. If I could prove I would make better use of the wallet and its contents than you (I would use it for good wealth maximizing purposes, you are a ne'er-do-well who will waste the money on wine, women, and song), then I would become the "legitimate" owner, that is, until someone else who could use it even more efficiently than I came and relieved me of it.

But this is not yet the bottom of the barrel as far as Coase and the "law and economics" movement is concerned. To add insult to injury to this thoroughgoing attack on private-property rights, the members of this school of thought saw themselves, and were widely perceived as, not critics of capitalism, but supporters. This is surely intolerable. It is one thing for a Proudhon, or a Marx, or a Stalin, to attack free enterprise. It is quite another, and altogether far more problematic, for those who march under the flag of the marketplace to be its most serious detractors.

Bethell, to his credit, sees through this scam. He summarizes this radical attack on the institution of private-property rights (p. 318): "Justice itself should be subordinated to efficiency—to economics." Characterizing this as a (p. 319) "strange doctrine," our author (p. 318) sharply rebukes Posner (1986), a leading Coasian, for the facile equation of justice and economic efficiency. He continues (p. 320):

> The claim that inefficient situations sometimes exist within a private-property system, thanks to high transactions costs, seemed [in Coase's initial formulation] to legitimize

[29]According to Cheung (1983, p. 20) between 1966 and 1980 it had garnered some seven-hundred citations; cited in Bethell (p. 315).

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> the rearrangement of all property rights by efficiency experts . . . It would render all property insecure and destroy the entire basis of the free-market system: exchange by consent. Thus, an exercise that began with Coase weakening the Pigovian rationale for government intervention went on to raise the possibility of a far more serious intervention.

Further, Bethell (p. 321) approvingly and correctly cites Simpson's (1996, p. 91) characterization of the Coasian system as "the end of the right of private property." Our author (pp. 321-22) is highly critical of Posner's (1986, pp. 128-29) analysis of *Ploof v Putnam* (1908) on the ground that the latter resorts to illegitimate interpersonal comparisons of utility.[30]

And yet despite the foregoing, Bethell's dismissal of Coasianism is not at all an unambiguous one. His blistering attacks on this system are marred by an admixture of actual praise. For example, he (p. 315) states: "*The Journal of Law and Economics* . . . was intended as an alternative to the strongly statist tendency of economics departments at that time." How can it be *anti*statist to undermine private-property rights? And again (pp. 316-17):

> The Coase theorem drew attention to one of the key contentions in this book: that transferable [exchangeable] property rights are the key to economic efficiency, to amity between neighbors and to peaceful relations in society more generally. Coase's insight has since been reformulated as one of the most basic principles of economics: When goods are owned in a well defined way, and the rights to them are exchangeable, they will be purchased by those who value them most highly.

Well-defined? How can property be well-defined if ownership is based not on past considerations but on future ones? As Bethell has himself shown us, well-definedness and property rights, for Coase, are antithetical. On the contrary, Coasianism is the paradigm case of *ill* defined property rights. Yet another evidence of equivocation: Bethell (pp. 319-20) cites as critics of Coasianism only the likes of Horwitz (1980), Leff (1974), Michelman (1979), Dworkin (1977) and Simpson (1996), few of them, with the possible exception of the latter, as thorough-going in their rejection of this system as the libertarian Austrians (Block 1977, 1995, 1996a; Cordato 1989, 1992a, 1992b; Krecke 1992; North 1990, 1992; Rothbard 1990). For Bethell, it is almost as if there are critics of Coasianism in economics only from the left, not the right.

Bethell sees the flaws in Coase, but lets him off easily, certainly, compared to how he treats Marx and Proudhon. But the latter two proudly wore their (coercive) socialist garb. Not so, Coase and Posner, and their ilk. One interpretation of this might be that on an intellectual plane Bethell sees through this Chicago attack on property rights. He is himself so much a part of this movement that he cannot quite bring himself to as harsh a judgment as might be warranted.

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[30]This is somewhat marred by Bethell's own transgressions in this regard (p. 320): "the level of inefficiency resulting from marginal impositions upon neighbors has never been established in practice. But it is surely low." How do we know this? How *can* we know this? Low, compared to what?

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Hayek as Libertarian

Hayek (1944) is characterized by Bethell (p. 147) as "a strong defender of private property." By no stretch of the imagination is this true. Very much to the contrary, Hayek makes dozens of exceptions to the free enterprise system (Block 1996c). There are some who defend Hayek on the ground that his views must be taken in context—that, apart from Mises, he was the strongest defender of private property in the decades in which he wrote, and thus deserved to be categorized as a staunch defender of private-property rights even though he was in effect no such thing. But this defense simply will not do. Even apart from Mises, there were libertarians writing in the 1940s and 1950s who were more consistent defenders of property rights than Hayek. The list includes writers like Ayn Rand, Henry Hazlitt, Albert J. Nock, Garet Garrett, Frank Chodorov, Robert LeFevre, H.L. Mencken, Baldy Harper, Leonard Read, W.H. Hutt, Bruno Leoni, Benjamin Anderson, John V. Van Sickle, Wilhelm Röpke, Lionel Robbins, Peter Bauer, and Isabel Paterson. Why just limit it to these decades? What about Benjamin Tucker and Lysander Spooner, who wrote long before Hayek? Surely they were far more radical than he.

Hayek as Austrian Economist

Bethell swallows whole the Hayek analysis of the failure of the Soviet Union. This view focused almost entirely on the inability of the central planners to obtain accurate information about the economy. First of all, much of it consisted of the knowledge of entrepreneurs specific to time and place; for example, the reliability and skills of various workers, the quickest way from this point to that, the honesty of merchants, the location of inputs, etc. None of this was readily quantifiable. Even and to the extent that it was, there would still be the difficulty of informational overload. Says Bethell (p. 142) in this regard:

> The problem can be appreciated by thinking about getting a message into the Oval Office. Speech writers in the White House itself cannot easily do it. They can pass on their brilliant ideas to the chief of staff—who might not think them so brilliant. He has other messages to deliver, and the president is busy.[31] Most messages must be excluded. A whole White House bureaucracy has already been established to decide which things are urgent, which things can wait.
>
> But in a planned economy, the planners were supposed to control minute details of faraway events. If a deputy commissar in Omsk needed Moscow's permission to switch a consignment of harvesters from one destination to another, he could wait—and ruin the harvest by abiding by the law.

In taking this stance, however, Bethell ignores the far more radical perspective of Mises. Worse, he claims (p. 144) that Mises's "more detailed criticism of planning . . . was really a variant of the problem of information."

[31] This line, I take it, was written before the advent of Monica-gate. Either that, or Bethell was too much "above the fray" to take note of it. I am not.

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This is entirely fallacious. Mises (1966, 1969) went so far as to demonstrate that *even if* this knowledge problem could be solved the central planners would *still* face insuperable barriers. The real difficulty for Mises was one of *appraisement* and rational *calculation,* not the relatively superficial one of knowledge. Forget about information pertaining to manufactures, and also consumer desires. Without meaningful market prices, based on the value appraisal of thousands of entrepreneurs, the economic dictator wouldn't know whether it was more efficient to build his limousine, yacht, or palace out of gold, silver, copper, brick, wood, plastic, or whatever,[32] let alone how to deal with the myriad of other decisions made in an economy greater than the size of the Swiss Family Robinson.

LAND REFORM

It is practically a shibboleth on the right that land reform is a pact with the devil, a plot to undermine private-property rights. Bethell certainly conforms to this pattern.

At a superficial level, evidence certainly abounds in support of this contention. Bethell (pp. 203–21) treats us to a survey of this policy as practiced in numerous countries all around the world. One error of his is to treat as successful all cases where the expropriation was peaceful (p. 206). What happened to justice? Merely because an act does not call forth outrage and resistance hardly renders it just.

A more basic methodological mistake is to treat all such transfers of property as if they were intrinsically a limitation on the rights of private property (p. 209) and never an instance of their implementation and protection. What raises Bethell's ire is land reform as an "immunization" (p. 208) against communism. If the only way to deflect this tyrannical system is to engage in land theft on a massive scale, perhaps there is not that much difference between the cure and the disease.

However, land reform can also, upon occasion, be properly interpreted not as an attack on the rights of private property, but as their main bulwark. Suppose A steals a farm from B, and then deeds it over to his son A1, whereupon, in due course, the grandson A2 inherits it from his father A1. Now, along comes B2, the grandson of the victim, and demands the return of this stolen property, e.g., land reform of a justified, that is, libertarian variety.

How is Bethell to reply? That all forced transfers of land are *per se* improper? But this would grant a stamp of approval to theft. If the robber or his heirs cannot be forced to relinquish their ill-gotten gains, this is a direct and utter *violation* of property rights. This insight is not confined to land. If it is true in that case, why not also for stolen cars, jewelry, money, television sets, etc. If we generalize, that will mean the absolute end to all private property.

[32]For the definitive rejection of Hayek, in favor of Mises, see Salerno (1992). More generally, for the de-homogenization literature on Hayek and Mises, pointing to the serious differences between them, and to the inferiority of the former *vis-à-vis* the latter, see Salerno (1990, 1995), Block and Garschina (1995).

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We need not be so theoretical. There are plenty of cases where land reform would *support* the rights of private property, not impair them. For example, consider the fall of the Berlin Wall and the end of the Soviet Union. There are now behind the ex-Iron Curtain thousands of acres of land, not to mention factories, houses, etc., which are occupied by people who cannot be considered their rightful owners, nor their heirs. Clearly, it would be just, it would be an implication of private-property rights, if these people were forced to vacate these premises, and cede them to those from whom they were initially stolen by the communists. One day, too, North Korea and Cuba will end their sorrowful decades-long experiment with communism and the same will apply there.

There are also cases closer to home. When the slaves were freed at the end of the Civil War, there was one very serious oversight: they were not compensated for the labor which had been in effect stolen from them. To wit, they had poured out their "blood, sweat, and tears" on those plantations, which were kept by their masters, and handed down to their own children. It would certainly be consistent with private-property rights, not a denigration of them, that this acreage be given over to the grandchildren of the slaves.[33] Of course, not any black person will do as a candidate to benefit from land reform below the Mason Dixon line. The burden of proof always rests with him who would overturn otherwise presumably legitimate property titles. This is why the *reductio* about overturning property theft from medieval or Roman times, to say nothing about caveman days, simply doesn't work. This libertarian version of property title transfer is naturally conservative. The further back in time you go, the harder it is to prove theft; and this is to say nothing of the absence of a written language and records.

But, at least, contrary to Bethell, this perspective does not entirely close down the possibility of land reform that actually promotes private-property rights.

Tradeable Emissions Rights

Bethell (p. 52) supports a tradeable emissions rights system, and goes so far as to characterize this as a "property mechanism." He states: "Air pollution can be controlled by giving emission permits to smokestack industries within a given air basin, and allowing these permits to be traded voluntarily."

This certainly fits well within the Chicago philosophy, but whatever such a scheme is, it is *not* compatible with property rights. Actually, it resembles nothing so much as the market socialist plan of Tito's Yugoslavia.

For pollution is a trespass. It is an uninvited border crossing of smoke particles, soot, or ground up and pulverized garbage. If this is not a violation of private-property rights, something about which the author of the *Noblest Triumph* could well be expected to object, then nothing is. But instead of calling for a ban on it, Bethell falls in

[33] For a debate between Milton Friedman, David Friedman, Paul Heyne, who took, roughly, the Bethell position on land reform, and myself, see Block, Brennan, and Elzinga (1985, pp. 495–510).

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with the compromisers, and advocates a system where polluters are allowed to engage in their nefarious activities, but only to a limited extent, covered with a veneer of rhetoric about a "property mechanism," as opposed to a property *right* to be free of invasions.[34] Bethell's colleague at the Hoover Institution, Anderson (1989, p. 19) is far more attuned to the essence of private property; here is his analysis of pollution:

> We have tried many remedies in the past. We have tried to dissuade polluters with fines, with government programs whereby all pay to clean up the garbage produced by the few, with a myriad of detailed regulations to control the degree of pollution. Now some even seriously propose that we should have economic incentives, to charge polluters a fee for polluting—and the more they pollute the more they pay. But that is just like taxing burglars as an economic incentive to deter people from stealing your property, and just as unconscionable.
>
> The only effective way to eliminate serious pollution is to treat it for what it is—garbage. Just as one does not have the right to drop a bag of garbage on his neighbor's lawn, so does one not have the right to place any garbage in the air or the water or the earth, if it in any way violates the property rights of others.
>
> What we need are tougher clearer environmental laws that are enforced—not with economic incentives but with jail terms.

FISH QUOTA

Based on his analysis of depleting fish stocks due to the tragedy of the ocean commons (p. 52), Bethell also supports marketable "fishing quotas," the water based analogue to tradeable emissions rights. These would give each boat owner the right to capture "a certain percentage of the overall permitted catch."

This would indeed address the "tragedy of the commons." This tragedy, however, springs *not* from communalism, but rather from coercion. To wit, governments so far refuse to recognize private-property rights in bodies of water.

The problem with fish quotas is that the government still administers this system, and sets the overall level of the catch. The oceans still remain a no man's land as far as real private-property rights are concerned. Why recommend a system with such an admixture of central planning? Why not go all the way to a radical private property stance and call for the privatization of oceans, rivers, lakes, streams, and seas[35] as well? Why this utter and total cave-in to the forces of water socialism?

This is a radical departure in today's anti-property right context. The problem is that this book was supposed to help change all that; instead, it accepts the very philosophy it is presumed by most reviewers to be challenging.[36]

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[34]For a defense against the argument that an outright ban on pollution would mean the end of industry and thus civilization, see McGee and Block (1994), and Rothbard (1990).

[35]And while we're at it, let's include the Arctic and Antarctica also, to say nothing of the moon, Mars, Venus and land on still other planets. Should socialism or capitalism be the order of the day regarding the frontiers of the earth and the heavenly bodies? Reading in between the lines of Bethell, the former is implied.

[36]Solomon (1999, pp. 43–47) mistakenly entitles his review of Bethell's book "A Paean to Property."

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It cannot be denied that there are many and serious obstacles to ocean privatization. But chief among them is the refusal of analysts such as Bethell to apply to the seas the private-property rights lessons we have achieved at such great expense on land.

For example, it will be argued by the Demsetzes (1967) of the world that it is costly to entertain property rights in water, and until and unless these expenses sharply decline, this proposal is a chimera. Bethell (p. 47), to his great credit, has rejected this argument on grounds of subjectivity. But there is more to be said against it. Of course there are conceptual, philosophical, practical, technological, and legal problems associated with ending the tragedy of the commons on the oceans, which have been so far enforced by the world's governments. How can fences be built to demarcate an owner's property from that of his neighbors? What to do about wandering fish stocks which do not respect lines drawn in the water? How about sharks and other predators? Will different people own different levels of the ocean; e.g., surface transport, mid-level fishing, and mining at the ocean floor or below? How will homesteading work in an arena in which it has not yet been tried?

This is not the time or place to even begin to give definitive answers to these questions.[37] Suffice it to say that these are challenges of degree, not kind: there is not a one of them that has not been dealt with on the land. For example, before there was barbed wire, there were "human fences," e.g., cowboys (Anderson and Leal 1991), and cattle branding; neither buffalo nor cows respect property lines drawn in the sand; sharks are merely wolves and cougars without feet; there are disputes and resolutions to the conflicting demands on the land for low flying planes, farming, and mining.

The bottom line, though, is that it is in a book of this sort that we would expect, if not progress on these issues, then at least an acknowledgement that private property can potentially play a role in this sphere. After all, the ocean, which comprises some 75 percent of the surface of the planet, probably accounts for less than 1 percent of global GDP. This is surely a way to promote "prosperity through property," the subtitle of this book.

CONCLUSION

In summary, this is a frustrating volume; it is close to libertarianism and Austrianism in many ways, yet doesn't quite make it.

Am I being unfair in characterizing Bethell as a Chicagoan? After all, there is not a good word from him on school vouchers, government money, antitrust, volunteer militaries to fight unjust wars, flexible exchange rates, negative income taxes, withholding taxes, and all the rest of the panoply of socialism emanating from this school of thought. Moreover, he does frontally attack stalwarts of the Chicago-inspired law and economics movement such as Coase, Posner, and Demsetz, even though, as we have seen, he pulls his punches. Perhaps most significantly, he avoids the facile Chicagoite equation of justice and efficiency.

[37] For an attempt, see Block (1992).

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On the other hand, he uncritically favors Public Choice (p. 282),[38] dismisses philosophical anarchism, sees monopoly as compatible with free markets (p. 51), buys into the public goods and free-rider market-failure arguments, ignores the contributions of libertarians such as Rothbard[39] and Hoppe who have devoted their entire careers to the defense of private-property rights, takes the Hayek side *vis-à-vis* Mises regarding central planning, accepts water and highway socialism, misunderstands communalism, and favors tradeable emissions rights.

At the end of the day, the best way to characterize him might be as a wannabe libertarian, or as a particularly good Chicagoan, or maybe even as a hybrid libertarian conservative.

The problem with Bethell, from my perspective, is that this is such a hardhitting book, so sound as we have seen in many ways, that it is likely to become the canonical text of private-property rights. Then, libertarians and Austrians shall be faced with the charge from critics of property, "Even Bethell concedes. . . . Even Bethell allows."[40] Libertarians and Austrians, in contrast, must be extremists or just plain wrong. No greater error could be committed than to ignore this truth.

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[38]For libertarian criticisms, see Rothbard (1997), DiLorenzo and Block (forthcoming).

[39]Not even to cite Rothbard once in his entire book is indeed a remarkable oversight. And this for two reasons, one public, the other private. The public reason is that Rothbard is the most eminent economist to have made private-property rights the bedrock of his philosophy. Why Bethell should totally ignore him is a puzzle on this ground alone. Second, I have in my hand a letter to me dated August 30, 1991, where this author asks my opinion of writings of Rothbard, David Friedman, and Paul Heyne, material from all three of whom would later be incorporated into his book. Bethell mentions the latter two, but not the former.

[40]Bethell (p. 141) reports that something of this sort has occurred with "Mr. Friedman, the American expert," whose imprimatur was used to support the accuracy of Soviet economic statistics in the 1930s.

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WINNERS, LOSERS, AND MICROSOFT: COMPETITION AND ANTITRUST IN HIGH TECHNOLOGY. BY STAN J. LIEBOWITZ AND STEPHEN E. MARGOLIS. OAKLAND, CALIF.: THE INDEPENDENT INSTITUTE, 1999

Antitrust regulation has been in a steep intellectual decline since at least the mid-1970s. Much of that decline has been due to the fact that Austrian and Chicago critics have eviscerated the conventional theory and empirical "evidence" that was said to rationalize traditional antitrust enforcement. A dwindling number of antitrust scholars now believe that market concentration, barriers to entry, foreclosure, or predatory practices can secure "monopoly" and misallocate resources. Similarly on the empirical side, the evidence that free-market dominant firms restrain trade and raise prices has proven to be nonexistent. Revisionist case analysis has demonstrated that most antitrust defendants were expanding output, innovating rapidly, and lowering prices. Thus, with no theory and no evidence, one might think that the critics had won the war and that antitrust would be headed straight for policy oblivion.

Well not quite. The resourceful antitrust community has simply gone ahead and reinvented itself by developing several *new* theories and an entirely new approach to evidence. (Unfortunately, the new approach is that favorable evidence no longer matters.) All of this is important since the antitrust enthusiasts and regulators intend to apply their newer theories to the current high-tech industry cases, most importantly *U.S. v. Microsoft*, where their application threatens substantial economic havoc. It is in this context that *Winners, Losers, and Microsoft* by Stan Liebowitz and Stephen Margolis, appears at a most opportune moment, indeed. This carefully written and thoughtful book is devoted to a critical examination of these new theories and to a search for evidence, *any* evidence, that these new theories can support antitrust.

The core of the newer theories is the notion of "network effects." Network effects arise whenever the value of a good to a consumer depends importantly on the number of *other* consumers that use the good, i.e., the more consumers that use computers with email or fax capabilities, the more valuable it becomes having a computer with such capabilities. These increasing returns (advantages) to consumers with compatible computers are clearly beneficial; *but*, say the critics, they tend to "lock in" some initial technological innovation as a kind of industry standard (and lock out would-be competitors) and create a fatal "path dependence" that ultimately can lead to (inefficient) monopoly for the first-mover firms.

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The most notorious example of a path-dependent standards monopoly is the so-called QWERTY typewriter keyboard. Critics hold that the placement of the keys (first developed for manual typing to curtail jamming) was always less than optimal, yet the inefficient standard persisted right into the computer age because of network effects and path dependence. Similarly, consumers have allegedly been "trapped" in several other high-tech market failure situations that require, supposedly, remedial antitrust regulation.

The devastating criticism by Liebowitz and Margolis of the newer market-failure theories occupies the first half of their book. They admit that network effects can exist and can be important to consumers in some (though certainly not all) industries. They even admit that network effects may lead to high market share (they call it "monopoly") in certain circumstances. But, breaking sharply with most theorists, they argue that the *process* of achieving the high market share outcome is both competitive and efficient and usually does not represent any market failure. Network effects provide efficient benefits to consumers and are not "externalities" that need any regulatory correcting. Moreover the competitive process (of attempting to monopolize) means that any monopoly is, ultimately, unstable and that newer, more efficient innovations will break through leading to some new monopoly. As they put it:

> These monopolies . . . are efficient outcomes in network industries, where the network effect, or scale economy, is strong. It is not our argument that such monopolies would never arise, but rather that these monopolies would not be locked in. Such industries are serial monopolies; one monopoly after another. . . . The stakes are always high in such industries. The new entrant seeks not to coexist with the incumbent, but rather to replace it. These high stakes, and the rivalry that they create, is apparently sufficient discipline to hold monopoly prices in check and to keep the rate of innovation very rapid. (p.15)

The second half of the book (including chap. 2 from the first half) is a series of case studies that aim to demonstrate the correctness of their theoretical conclusions. Do network effects lead to monopoly, and does one monopoly tend to replace another? Are inefficient standards or technologies locked in and can they be unlocked by the free-market process? And most importantly for antitrust purposes, how have successful firms (like Microsoft) achieved their dominance with respect to certain products? And once firms achieve market dominance, what happens to price and innovation?

The case studies are fascinating. The QWERTY keyboard, supposedly a path-dependent mistake, is shown to be the result of an efficient market process; the superiority of the so-called Dvorak keyboard is exposed as a myth. VHS format videorecorders deserve their success; they became the industry standard when they offered a longer playing time then Beta. Command-line DOS was faster than Macintosh and had a cost advantage, while Microsoft platforms demonstrated a commitment to backward compatibility, Apple did not seek continuity in its operating systems—and lost its customers. The Lotus spreadsheet ultimately failed

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because of strategic managerial errors and because "competing products (such as Excel) were judged to be superior in quality." Indeed, the general argument and evidence with word processors, personal-finance software, desktop-publishing software, and browsers is that consumer perceived *quality* ultimately determines market share. Alternatively, when products perform poorly, as with Microsoft's online service, Microsoft Network, even bundling them into the desktop cannot make them successful.

The last chapter in the book, an appendix, is devoted to the current government antitrust case against Microsoft. Aside from network effects and lock-in theories already examined, Liebowitz and Margolis argue persuasively that the government's case is intellectually wrongheaded with potentially disastrous economic consequences. They shred the government's theories of monopoly leverage, tie-ins, predatory bundling, and underscore the fact that the government has *no* evidence whatsoever that Microsoft has restricted outputs or raised prices. (Economists for the government seem unaware and even uninterested in any empirical evidence.) Their greatest concern is that the government and many industry critics have proposed "freezing the operating system" and limiting any additional functionality as an antitrust remedy. Such innovational regulation would be a disaster.

This is an intelligent book that does much to demonstrate that the antitrust emperor wears few clothes. What the authors choose to say they say clearly and persuasively. Especially welcome is their central theoretical theme: that the market is a process that works efficiently for consumers and that the competitive market process looks like a series of "monopolizing acts." Indeed, they speak harshly of "textbook models of competition" that take price and the nature of the product as "given." And if efficient "serial monopoly" is the actual nature of competition in high-tech industries, then this condition must alter current notions of antitrust enforcement.

All true, but surely the bulk of this has been said many decades earlier by prominent Austrian theorists such as Mises, Hayek, Rothbard, Kirzner, and especially Schumpeter. One gets the impression (perhaps mistakenly) from their exposition that these ideas are recently discovered; certainly their intellectual origins are not detailed and none of the above theorists are even cited. (There is a strange passing reference [p. 244] to Hayek in a note [no index citation] but that is all.) Yet in a book where "history matters" in the success of quality products, one has a right to expect more history (and credit) for the Austrian theorists in their development of a correct theory of competition.

Also unclear is the status of competition theory generally and the proper application of antitrust, if any. Does their process theory of competition *replace* the orthodox model? And if not, why not? They tell us approvingly at one point that several economists have observed that the competitive model "is somewhat distant from perfect competition." Somewhat distant??! And that their own theory of serial monopoly "alters the antitrust world somewhat." Alters it somewhat??!

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Why the caution here? The process theory of competition has nothing whatever in common with the orthodox approach: they are antithetical. The authors might reply that the process theory only applies if there are strong network effects, but this reviewer strongly disagrees. The process theory of competition applies to *any* open market and a review of previous antitrust cases would have demonstrated that truth beyond a doubt. Although Liebowitz and Margolis are skeptical of the application of antitrust to high-tech industries, they might have been skeptical about the entire antitrust world where "winners" have been routinely attacked for decades. Unfortunately, there is precious little antitrust history in this book; and it is difficult, therefore, for the lay reader to place the Microsoft disaster in any sort of context. It's clear that the authors mistrust conventional competition theory and antitrust policy but we are not quite sure how they would draw the theory and policy lines in different industries or with different issues at stake, e.g., price agreements and large mergers.

These are quibbles about things that the authors didn't choose to write about. What they *did* say is intelligent and important and deserves the widest possible understanding. The stakes are very high; regulatory control of product innovation in high tech industries would be disastrous. Professors who teach industrial organization, and all judges who decide antitrust cases, will profit immensely from reading this book.

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ANTITRUST: THE CASE FOR REPEAL. BY DOMINICK T. ARMENTANO. AUBURN, ALA.: MISES INSTITUTE, 1999

Most economists would, given the opportunity, offer some proposal to reform antitrust policy. Some would contend that this or that aspect of antitrust law should be eliminated or more weakly enforced. Only a brave few, however, deliver a deadly blow to the antitrust beast. In the revised second edition of his book *Antitrust: The Case for Repeal*, Dominick T. Armentano is not content to attack only one aspect of antitrust policy. Professor Armentano proceeds to demolish the very foundations of antitrust policy. No excuse for antitrust intervention remains standing—not predatory pricing, not tying agreements, not even price fixing. Lighter fare than his excellent book *Antitrust and Monopoly* (1990), Armentano's *Case for Repeal* provides a coherent, accessible Austrian perspective on senseless and unjust antitrust law.

Armentano's first chapter focuses on the Microsoft case. His cogent analysis of path dependence as an aspect of the Department of Justice's attack is similar to, and draws from, earlier work by Liebowitz and Margolis (1990, 1995). Armentano's concerns are much broader, however, and he uncovers the grievous errors in the government's understanding of the competitive process they claim to be promoting. Microsoft's decision to integrate its web browser into its Windows operating system was an effort to compete more effectively with its rival Netscape. If its innovation is judged by consumers to be superior, and is attained without legally restricting the entry of other firms, why should the Department of Justice balk at a resulting increase in market share? Antitrust intervention is an assault on efficiency and revealed consumer preferences.

In addition to the Microsoft case, Armentano considers several other key cases throughout the book: *Standard Oil* (decided 1911), *Alcoa* (1945), *AT&T* (1982), *Staples-Office Depot* (1997), and others. With each case Armentano refutes another argument for antitrust. In contrast to many neoclassical critiques of antitrust, the approach in *The Case for Repeal* is not empirical. Basing his views on sound economic theory, Armentano finds the weapons of logic quite sufficient to dismantle commonly accepted antitrust theory.

Rothbardian monopoly theory, summarized in an appendix to chapter three, is generally consistent with Armentano's own approach. In Rothbard's understanding of the market, information is never perfect, all sellers have some influence over price, and goods are never completely homogeneous (Rothbard 1993, pp. 560–660). Where information is imperfect, discovery matters. Antitrust authorities

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might regard an increase in price (or a decrease in price) as monopolizing behavior, when in fact the change could be due to the discovery of new information about the market. Firms make mistakes, produce too much at times, and must reduce output and raise price. Because static equilibrium conditions can never exist in the disequilibrium of the actual market, and no demand curve is perfectly elastic, the conditions of perfect competition can never obtain. Comparing "competitive" and "monopoly" prices is therefore an exercise in futility—there are no independent criteria that would allow us to distinguish between the two.

Furthermore, in a world of subjective costs and benefits, antitrust authorities seeking to deter activities that reduce social welfare and social efficiency cannot have the information necessary to make good decisions. This last point is relevant when considering the "rule of reason" reforms that some have advocated for antitrust regulation. The "rule of reason" approach, which implies that the government ought to permit an activity when the social gains are expected to outweigh the social losses, fails for lack of sufficient information. Costs and benefits are not cardinally measurable, foreclosing any possibility of antitrust authorities summing up individual costs and benefits into useful aggregates. "Individual consumer and producer utility and surplus may exist, but these notions cannot be mathematically manipulated to allow any regulatory rule-of-reason judgments" (pp. 49, 50).

Looking at profits to determine if a monopoly exists and what its social costs might be is also problematic. Accounting profit is used to estimate economic profit, a theoretically illegitimate procedure. Even if this obstacle could somehow be overcome, the mere existence of monopoly profits does not justify government intervention. Government involvement in the marketplace is so widespread that the legal monopolies it forms "might well be inexorably intertwined in the actual business world: tariffs, quotas, licensing, and other legal restrictions always tend to generate economic rents in markets that are otherwise openly competitive" (p. 44).

Could we find in this a justification for keeping antitrust law on the books? Some have suggested that we turn antitrust law against the government by using it to break up government-enforced monopolies. Armentano maintains that this is ill-advised. As long as antitrust regulation exists, the danger remains that it will be turned against private business.

Armentano closes his book by contending that antitrust law violates basic principles of liberty. Even if it could be shown that efficiency dictates necessary legal constraints on market structure, antitrust law clearly interferes with essential rights to private property. Armentano writes:

> The antitrust prohibition of price discrimination, merging, price fixing, and even free-market monopolization prevents freely contracting parties who hold legitimate rights to property from making, or refusing to make, certain contractual arrangements that they believe to be in their best interests. . . . [P]rivate and peaceful activities such as

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> price discrimination, merging, tying, and price fixing violate no property rights in the ordinary sense of the term; that is, they do not necessarily involve force, fraud, or misrepresentation. (pp. 99, 100)

It is entirely appropriate that low-cost sellers be rewarded with market share. Competition, in the sense that there are no legal barriers to entry, still exists even if an industry is highly concentrated. To interfere with the competitive process, to prosecute firms that undercut the prices of their rivals, "is blatantly protectionist of the existing market structure of suppliers" (p. 70). This, perhaps, is the real story of antitrust. Armentano shows quite effectively that no public interest rationale exists for antitrust regulation. Case after case reveals a common thread—outwitted, outperformed rivals seeking to use the brute force of government to put down their opposition. "Antitrust's dirty little secret," charges Professor Armentano, "is that the laws have been employed consistently to hamper successful business organizations and protect their less efficient rivals. One would be hard-pressed to discover a more immoral or irrational public policy toward business, or one more worthy of repeal" (p. 12).

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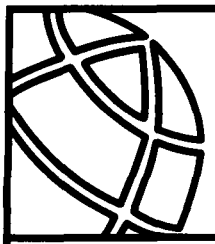

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